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2004

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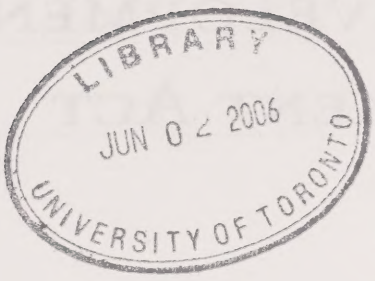
Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

2004

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Introduction

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aims are to foster the transition towards open, market-oriented economies in Central and Southeastern Europe, as well as in the successor states of the former Soviet Union,[1] and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multi-party democracy, pluralism and a market economy (see Annex 3 for a list of the EBRD's 27 countries of operations).

The EBRD differs from other multilateral development banks in four ways. First, its overriding focus is the private sector and support for the transition from central planning to stable market economies. Its charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. Second, it has a particular focus on the promotion of democratic institutions and human rights in its countries of operations. Third, while all multilateral development banks are committed to ensuring the environmental sustainability of their projects, the EBRD is the only such institution where this commitment is explicitly written into its Articles of Agreement. Fourth, the EBRD does not provide concessional financing.

The Bank seeks to help its 27 countries of operations to implement structural and sectoral economic reforms, taking into account the particular needs of countries at different stages in the transition process. In particular, its private sector activities focus mainly on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD has 62 members: 60 countries, the European Union (EU) and the European Investment Bank (see Annex 3 for a list of members).

Canada is the eighth largest shareholder (tied with Spain), following the other Group of Eight (G-8) countries. Canada's formal participation is authorized under the European Bank for Reconstruction and Development Agreement Act, which was promulgated in February 1991. Article 7 of the Act states that:

> The Minister [of Finance] shall cause to be laid before each House of Parliament by March 31 of each year or, if that House is not then sitting, on any of the thirty days next thereafter that it is sitting, a report of operations for the previous calendar year, containing a

[1] In 2004, Governors voted to make Mongolia a country of operations, recognizing its close linkage with the former Soviet economy and its long history with a centrally planned economy. This process will not be complete until all members adopt the necessary amendment to their domestic legislation governing their relations with the Bank.

> general summary of all actions taken under the authority of this Act, including their sustainable development aspects within the meaning of Article 2 of the Agreement, and their human rights aspects.

This report responds to this requirement and reviews the activities and operations of the Bank for the year 2004.

Benefits of Membership

As a major trading nation, Canada has a stake in global peace and stability, which the successful integration of Central and Southeastern Europe and the former Soviet Union into the world economy and global institutions helps to promote. By fostering continued political and economic reform in the region, the EBRD is contributing to its integration into the world economy and to its stability.

The Minister of Finance is a Governor of the Bank and nominates a Director to its 23-member Board. This representation allows Canada to have high-level influence on decisions taken by the EBRD on investments in the region and on policies to move countries through the transition process. The EBRD also provides trade opportunities for the Canadian private sector, supporting a diversification of international markets for Canadian businesses.

Details on Canada's financial contributions to the EBRD are provided in Annex 1.

The EBRD

- fosters the transition of former centrally planned economies of Central and Southeastern Europe and the successor states of the former Soviet Union towards market-oriented economies;
- promotes private entrepreneurial initiative by targeting at least 60 per cent of its resources to private sector projects, with the balance in support of commercially viable state sector projects that promote private sector development;
- operates only in countries committed to applying the principles of multi-party democracy, pluralism and market economics;
- promotes environmentally sound and sustainable development; and
- operates on a self-financing basis.

Role and Mandate of the EBRD

The EBRD's operations to advance the transition to a market economy are guided by three principles: maximizing transition impact, additionality, and sound banking. Financing is provided for projects that expand and improve markets, help to build the institutions necessary for underpinning a market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also be additional to other sources of financing and not displace them, further ensuring that the Bank contributes to the transition process. Finally, Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers attractive returns. Adherence to sound banking principles also helps to ensure the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector.

In promoting economic transition in its countries of operations, the Bank acts as a catalyst for increased flows of financing to the private sector. The capital requirements of these countries cannot be fully met by official multilateral or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the central Asian republics. By providing an umbrella under which wider funding for private sector investment can be assembled, the EBRD plays a catalytic role in mobilizing capital. In 2004, for every euro the EBRD invested, it mobilized an additional 2.1 euros from the private sector and other multilateral and bilateral agencies.[2] Commercial co-financing mobilized by the EBRD reached a record volume of 3.5 billion euros in 2004, up 34 per cent from the previous high in 2003.

The Bank's projects serve a dual purpose. They are intended not only to directly support the transition from a command to a market economy in countries of operations, but also to create a demonstration effect to attract foreign and domestic investors. Like the World Bank Group's International Finance Corporation, the Bank is required to operate on a strictly commercial basis and to attract companies through financially viable projects, not through subsidies.

[2] On December 31, 2004, one euro purchased 1.6292 Canadian dollars.

Key Economic Developments in 2004

Most of the transition economies experienced economic growth in 2004, accompanied by a rapid rise in domestic bank lending that has boosted investment and consumption. Most countries in the region continued to perform well in comparison with other emerging markets. The exception continues to be the poorer countries in the Commonwealth of Independent States (CIS),[3] where the reform process continues to lag and uncertain climates continue to discourage domestic and foreign investment.

The process of transition to market-based economies continued to advance in most of the EBRD's countries of operations. Belarus, Turkmenistan and Uzbekistan are the exception, with reform largely stalled at a very early level of transition. The results of the Bank's annual assessment of key transition indicators are summarized in the following table.

[3] The CIS includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

Progress in Transition in EBRD Countries of Operations

			Enterprises			Market and trade			Financial institutions		Infra-structure
Countries	Population (millions, mid-2004)	Private sector share of GDP in %, mid-2004 (EBRD estimate)	Large-scale privatization	Small-scale privatization	Governance and enterprise restructuring	Price liberal-ization	Trade and foreign exchange system	Compe-tition policy	Banking reform and interest rate liberalization	Securities markets and non-bank financial institutions	Infra-structure reform
Albania	3.2	75	2+	4	2	4+	4+	2▲	3-▲	2-	2
Armenia	3.1	75▲	3+	4▲	2+	4+	4+	2	2+	2	2+
Azerbaijan	8.3	60	2	4-	2+	4	4-	2	2+	2-	2
Belarus	9.9	25	1	2+	1	3-	2+	2	2-	2	1+
Bosnia and Herzegovina	3.8	50	2+	3	2	4	4-	1	3-▲	2-	2+
Bulgaria	7.8	75	4▲	4-	3-	4+	4+	2+	4-▲	2+	3▲
Croatia	4.4	60	3+	4+	3▲	4	4+	2+	4▲	3-	3▲
Czech Republic	10.3	80	4	4+	3+	4+	4+	3	4-	3+▲	3+
Estonia	1.4	80	4	4+	3+	4+	4+	3-	4▲	3+	3+
FYR Macedonia	2.0	65▲	3+▲	4	2+	4	4+	2	3-	2▲	2
Georgia	4.6	65	3+	4	2	4+	4+	2	3-▲	2-	2+
Hungary	10.0	80	4	4+	3+	4+	4+	3	4	4-	4-
Kazakhstan	14.4	65	3	4	2	4	3+	2	3	2+	2+
Kyrgyz Republic	4.8	75▲	4-▲▲	4	2	4+	4+	2	2+	2	2-▲
Latvia	2.3	70	4-	4+	3	4+	4+	3-	4-	3	3
Lithuania	3.5	75	4-	4+	3	4+	4+	3	3	3	3-
Moldova	4.3	50	3	3+	2-	4-	4+	2	3-▲	2	2
Poland	38.3	75	3+	4+	3+	4+	4+	3	3+	4-	3+
Romania	21.7	70▲	4-▲	4-	2	4+	4+	2+	3▲	2	3+▲
Russia	144.9	70	3+	4	2+	4	3+	2+	2	3-	3-▲
Serbia and Montenegro	8.3	50	2+	3+▲	2	4	3+	1	2+	2	2
Slovak Republic	5.4	80	4	4+	3	4+	4+	3	4-▲	3-	3-
Slovenia	2.0	65	3	4+	3	4	4+	3-	3+	3-	3
Tajikistan	6.5	50▲	2+	4-	2-	4-	3+	2-	2▲	1	1+
Turkmenistan	6.0	25	1	2	1	3-	1	1	1	1	1
Ukraine	48.4	65	3	4	2	4	3	2+	2+	2+▲	2
Uzbekistan	26.0	45	3-	3	2-	3-	2-	2-	2-	2	2-

Note: The classification of transition indicators uses a scale from 1 to 4, where 1 implies little or no progress with reform and 4 implies a market economy. A rating of 4+ indicates the country has achieved standards and performance typical of advanced industrial economies. ▲ arrow indicates change from the previous year. One arrow indicates a movement of one point (from 4 to 4+, for example) and two arrows a movement of two points.

Source: EBRD, 2004 *Transition Report*.

Russia

Russia's economic growth is estimated to have slowed to 7.1 per cent in 2004, down from 7.3 per cent in 2003. Economic growth continued to be driven by high oil prices, increasing oil export volumes and stronger investment, which was mainly directed to the energy sector. High taxation revenues from the oil and gas sectors led to a fifth straight budgetary surplus in 2004 and allowed the Oil Stabilization Fund to reach the equivalent of US$19 billion by year-end.

Monetary policy continued to be guided by the dual objective of reducing inflation and limiting real appreciation of the ruble. The central bank continued to intervene heavily in the foreign exchange market in 2004, allowing Russian authorities to increase their foreign exchange reserves to a record-high US$125 billion by the end of 2004. Difficulties in sterilizing this rapid reserve accumulation have, however, resulted in a surge in money growth, which in turn has contributed to higher-than-expected inflation. Year-end consumer price inflation in 2004 was 11.7 per cent, well above the initial official target of 8–10 per cent.

There are growing concerns that Russia's oil-driven boom may be losing steam. These concerns have led Russian authorities to decrease their 2005 growth forecast to 5.8 per cent. In order to promote more sustainable growth, Russia needs to diversify its economy by implementing structural reforms aimed at increasing economic activity in the non-energy sector and at improving the overall investment climate. Russia's investment climate was clouded in 2004 by concerns of growing government interference in the economy, triggered by the Yukos affair. Concerns about the business climate contributed to net capital outflows of US$7.8 billion in 2004, quadruple 2003's outflow. Unless structural reforms enable other sectors of the economy to develop, Russia's dependence on natural resource exports will increase, and economic growth will continue to fluctuate in tandem with oil and other raw material prices.

Other CIS Countries

Other oil-exporting CIS countries continued their rapid economic growth in 2004. This strong growth largely reflected revenue from sustained high oil prices and rising fixed investment in resource-based sectors. Kazakhstan recorded the strongest economic growth among oil-exporting CIS countries in 2004, with estimated real gross domestic product (GDP) growth of 9.4 per cent, mainly due to a continuing investment boom in the oil and gas-related sectors. Azerbaijan also maintained strong growth momentum at 7.8 per cent in 2004, fuelled by the construction of the Baku-Tbilisi-Ceyhan pipeline, which will begin operations in mid-2005.

Many of the remaining CIS countries have also benefited from high non-oil commodity prices. These include Ukraine (steel), Tajikistan (aluminum), the Kyrgyz Republic (gold) and Uzbekistan (gold). High commodity prices have also had positive indirect effects on other economic sectors, such as services and construction. Despite its year-end political crisis, Ukraine is estimated to have recorded real GDP growth of 12.0 per cent in 2004, up from 9.4 per cent in 2003. Decisive action to address double-digit inflation and large increases in government spending will be crucial, however, to deal with the mounting pressures on the economy. Growth rates in Tajikistan, the Kyrgyz Republic and Uzbekistan all increased in 2004 compared to the previous year, although per capita incomes in these countries still remain very low relative to other CIS countries.

Reforms must urgently address the chronically poor investment climates and weak institutions if these countries are to enjoy stronger growth over the medium and longer term.

Central Europe[4]

In 2004, the economies of Central Europe grew by an average of 4.9 per cent, up from 3.8 per cent in 2003, driven primarily by domestic demand and increasingly by an expansion of exports.

The Baltic States continued to register strong growth in 2004, led by Latvia, which grew by 8.5 per cent for the second consecutive year. All Central Eastern European countries recorded significant real GDP growth in 2004. In particular, growth in Poland increased strongly to 5.4 per cent, up from 3.8 per cent in 2003, buoyed by exports and investment. Growth in Hungary also picked up, rising from 2.9 per cent in 2003 to 4.0 per cent in 2004.

Economic conditions across the region contributed to the improvement in government deficits from an average of 3.6 per cent of GDP in 2003 to 3.2 per cent of GDP in 2004. However, several large Central Eastern European countries have failed to bring their fiscal positions under control. Fiscal deficits as a per cent of GDP in Hungary (5.6), Poland (5.4) and the Czech Republic (3.4) have remained substantial, and further fiscal consolidation will be required. In order to meet the Maastricht criteria for monetary union (to join the euro), among other things these countries must reduce their public deficits to 3 per cent of GDP or less.

The average current account deficit in Central Europe remained at 5.8 per cent of GDP in 2004. High investment and consumption levels, fuelled by a booming credit market (particularly for consumer finance), have led to sustained demand for imports.

[4] Includes the Czech Republic, Hungary, Poland, the Slovak Republic, Slovenia and the three Baltic States (Estonia, Latvia and Lithuania).

Following a sharp drop from 6.6 per cent of GDP in 2002 to 2.4 per cent of GDP in 2003, foreign direct investment (FDI) is estimated to have increased marginally in 2004. In Hungary and Poland, FDI inflows were replaced by less stable portfolio inflows, which have increased their vulnerability to sudden reversals in capital flows. The decline in net inflows of FDI reflects the tapering off of major privatization deals as a source of FDI, and the increasing difficulty in attracting greenfield investments.

Accession to the European Union

2004 marked a milestone in the EBRD's short history, with 8 of its 27 countries of operations joining the EU on May 1 (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia). As the transition process advanced in Central Europe, the Bank began to slowly shift its operations to the less advanced transition countries, particularly as it begins to implement the newly approved Early Transition Countries Initiative.[5] In line with its principles of transition impact, sound banking, and additionality, the EBRD also sharpened the focus of its operations in the advanced transition countries. The beneficiaries of EBRD operations in these countries are now largely small and medium-sized municipalities that cannot obtain funds elsewhere without a sovereign guarantee and small and medium-sized enterprises that require equity or longer-term commercial financing on reasonable terms. Co-financing with EU structural funds also figures in the Bank's activities in the new EU countries.

Southeastern Europe[6]

Increased political stability, although still fragile in some cases, and the prospects of EU membership for Bulgaria (for entry in 2007), Romania (for entry in 2007), and Croatia (accession negotiations to begin in April 2005) are motivating structural reform and economic growth in Southeastern Europe.

Average real GDP growth increased from 4.4 per cent in 2003 to 5 per cent in 2004. Growth in Albania and Romania has been particularly strong (6.2 and 8.0 per cent, respectively). Only FYR Macedonia (2.5 per cent) is lagging behind the region, which is partly due to persistently low per capita net FDI inflows.

[5] Advanced transition countries include Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. The early transition countries are the Bank's seven poorest countries of operations: Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan. Intermediate transition countries include the balance of the EBRD's countries of operations, excluding Russia. The EBRD considers Russia to be in a category of its own.

[6] Southeastern Europe includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia (FYR Macedonia), Romania, and Serbia and Montenegro.

Throughout the region, rapid real GDP growth has been associated with the expansion in bank lending (domestic bank lending grew by 23 per cent in 2003), leading to higher consumption levels. Credit has expanded particularly quickly in Bulgaria and Romania. Excessive credit growth, however, can lead to vulnerabilities in the financial sector, with possible repercussions for public and corporate sector creditworthiness and exchange rate stability. This has prompted the introduction of tighter regulations on bank lending in many countries.

General government deficits averaged less than 3 per cent of GDP in 2004. Albania and Croatia were the only countries with fiscal deficits above this level. In contrast, FYR Macedonia reduced its deficit to around 1 per cent of GDP, reflecting significant fiscal consolidation.

Current account deficits remained large throughout the region, averaging 8.8 per cent of GDP. In Bulgaria, the current account deficit remained above 8 per cent due to the credit-fuelled consumption boom.

In contrast to Central Europe, net FDI into Southeastern European countries has remained at historically high levels for the second year in a row. This has mainly been generated by large privatization contracts. The increase in net FDI inflows—and the simultaneous decrease of flows into Central Europe—also partly result from European investors relocating business activities to Southeastern European countries, with the aim of taking advantage of lower unit labour costs and taxation levels than those in some Central European countries.

Canada's Cooperation With the EBRD in Southeastern Europe

In response to the Kosovo crisis in 1999, the EBRD developed the South Eastern Europe Action Plan (SEEAP), which seeks to promote investment and to assist in the economic recovery of the region. Eligible countries are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, and Serbia and Montenegro.

Under the SEEAP, EBRD investments focus on developing commercial approaches to infrastructure (such as telecommunications, airports, and municipal and environmental infrastructure), micro, small and medium-sized enterprises, and the financial sector. These investments address the transition challenges facing the region: crumbling infrastructure; a weak industrial asset base; mostly small, fragile banks; and pervasive problems of poor governance.

To date, Canada, through the Canadian International Development Agency (CIDA), has committed $18 million in support of the EBRD's SEEAP activities. The total Canadian contribution is being used for technical assistance and co-financing related to project preparation and implementation, advisory services, and capacity building. Canada's assistance is contributing to the efforts of both the EBRD and the international community in supporting the transition process and in promoting stability in the region.

In 2000, CIDA committed a total of $12 million to Phase I of the CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE), of which $2 million was designated for the Balkan Region Special Fund (BRSF) to support post-conflict reconstruction efforts in the Balkan region. The total amount ($12 million) has been earmarked against 36 projects approved by CIDA—26 against the BRSF and 10 against the CIDA-EBRD CFSEE Program.

In March 2003, CFSEE Phase II, valued at $6 million, was launched. Phase II builds upon the results of Phase I and adheres to a more focused programming approach in line with CIDA's Strategy for the Balkans Region. In Phase II, Canadian funding is targeted to countries that CIDA identified as priority countries—Bosnia and Herzegovina, and Serbia and Montenegro. Projects with a regional focus are also supported under Phase II and these may include other countries in the Balkans.

2004 *Transition Report*

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition from a centrally planned to a market economy in each of the Bank's 27 countries of operations. The *Transition Report* is recognized as the leading publication analyzing the progress of transition in the former Soviet bloc. Infrastructure, and the private sector's role in its provision, was chosen as the special theme of the 2004 report in recognition of the shift in thinking about infrastructure. Apart from the EBRD, international financial institutions (IFIs) had reduced their involvement in core infrastructure services on the assumption that, with proper regulation, the private sector could finance and operate these services. However, the expected private financing did not materialize. Contributing factors were the global economic slowdown (2000–2003) and the coinciding crises in the international telecommunications and electricity markets that led to a scaling back of private sector investment in emerging markets. Thus, realizing that good infrastructure is essential for economic development and poverty alleviation and that the private sector will not do it alone, infrastructure is back on the IFIs' agendas.

In the transition economies, the infrastructure challenges are maintaining and upgrading service networks and developing rules and regulations that encourage efficient, cost-effective, environmentally sustainable and affordable services. The 2004 *Transition Report* assesses the potential contribution the private sector can make to infrastructure, and suggests past expectations were too high. The changing nature of private sector participation, with the private sector increasingly providing management skills rather than capital investment, will make the arrangements less risky for both the government and private sector partners. It suggests that strengthening regulatory institutions and removing political constraints can improve the success of private sector participation. Tariff reform is a particularly challenging area, and the report suggests that innovations, including "lifeline" tariffs that allow a certain level of services to be provided free of charge, offer a way to address equity concerns while improving the overall efficiency of services.

2004 FINANCIAL RESULTS

In 2004, the EBRD realized another strong financial performance with profits after provisions of €297.7 million, below last year's figure of €378.2 million but significantly higher than previous years. The EBRD continued to see a reduction in its impaired assets (non-performing loans) in 2004. At December 31, 2004, the EBRD had €86 million in impaired loans, compared with €125.2 million at the end of 2003. The EBRD's general administrative expenses in 2004 were £138.1 million, compared to £132.8 million in 2003.

Financial Highlights

- The Bank recorded €4.1 billion of new operations in 2004, an increase of €400 million from 2003. Of this amount, 47 per cent was approved for early and intermediate transition economies in the former Soviet Union and Southeastern Europe. Another 23 per cent went to the advanced transition countries of Central Europe and 30 per cent to Russia.
- As the institution reports its financial results in euros, the depreciation of the US dollar in 2004 reduced the euro value of EBRD operations, given that many of its operations (and especially those in CIS countries) are transacted in US dollars.
- Profits after provisions were €297.7 million, down from €378.2 million in 2003 but significantly higher than in past years.
- Total provisions on banking assets were €1.1 billion at the end of 2004, the same as at the end of December 2003.
- Gross disbursements, at €3.4 billion, were up strongly (60 per cent) from 2003.
- The Bank mobilized €2.1 in additional financing for every euro that it invested in 2004, compared to €1.4 in 2003.
- The private sector share of annual business volume was 86 per cent, up from the 79 per cent reported in 2003 and the highest share to date.
- Administrative expenses were £138.1 million, continuing a 10-year trend of no real increases in approved budgets. Indeed, actual administrative expenses in 2004 were once again somewhat below the approved budget for the year.
- Reserves[7] at the end of 2004 were €1,786 million, up sharply from €989.6 million at the end of 2003, primarily reflecting net profits for the year and an increase in the fair value of the Bank's listed share investments.

[7] Reserves are Bank capital set aside to cover unexpected losses.

The EBRD approved 129 projects in 2004, up from 119 the previous year. These commitments totalled €4.1 billion, up from €3.7 billion in 2003, surpassing the €3.5-billion to €3.9-billion target range of the Bank's medium-term operational strategy. Net cumulative commitments by the end of 2004 amounted to €15.4 billion, breaking the €15-billion threshold for the first time. The level of disbursements, at €3.4 billion, was over 60 per cent above the €2.1 billion recorded in 2003. Net disbursements were particularly high in the early and intermediate transition countries, and slightly negative in the advanced transition countries (due to strong reflows from these countries). Guarantees decreased by 24 per cent to €180 million at the end of 2004.

Even as the Bank increases its emphasis on the early transition countries—where the investment climate is particularly risky—it continues to follow sound banking principles, as the overall financial performance for 2004 indicates.

Institutional Developments

Early Transition Countries Initiative

In early 2004, the Bank launched a new initiative for the seven early transition countries (ETCs). With the accession of eight of the Bank's borrowing members to the EU, it has become increasingly necessary for the Bank to shift its focus to its less advanced borrowing members. The new initiative aims to stimulate market activity in these countries by using a streamlined approach to financing more and smaller projects, mobilizing more investment, and encouraging ongoing economic reform. Governors agreed that the Bank should accept higher risk in the projects it finances for the ETCs, while still respecting the principles of sound banking. The Bank has established a Multi-Donor Trust Fund to help support this new initiative. This fund will coordinate grants, financed by bilateral donors, to catalyze investment in these countries by paying for technical cooperation, advice on regulatory and governance improvements, and co-financing for investments with widespread economic and social impact.

Reflecting the Bank's comparative advantages, the ETC strategy will emphasize private sector development, particularly in micro, small and medium-sized enterprises. The Bank is currently developing or refining several financing instruments dedicated to the funding of local entrepreneurs and enterprises. The initiative also promotes financing of smaller government infrastructure investments appropriate to local consumers' ability to pay for improvements in these services (e.g. water, heating).

Excluding oil and gas extraction and pipeline projects, the Kumtor restructuring and the Azerbaijan Silk Road project (major investments not directly affected by the new strategy), business volume increased from €84 million in 2003 to €93 million in 2004, encouraged by the ETC Initiative.

Private Sector Development

Fostering the development of strong private sectors in its countries of operations is an essential element of the EBRD's strategy for promoting the transition to a market economy. A strong small and medium-sized enterprise (SME) sector is one means of developing a "constituency for reform" in the transition economies that can act as a counterweight to powerful vested interests that benefit from weak state governance. The Bank's Articles require it to commit at least 60 per cent of its portfolio to private sector activities, both globally and in individual countries. The global portfolio ratio was first satisfied in 1994 and has grown to a record high of 86 per cent in 2004.

A core part of the EBRD's work with the private sector is its support of micro, small and medium-sized enterprises (MSMEs), which are important engines for job creation and growth, and therefore poverty reduction. The Bank's strategy for the MSME sector is founded on three pillars: financing, improving the investment climate through policy dialogue, and developing business support networks for MSMEs. The strategy explicitly recognizes that the poor investment climate, and not just limited access to financing, is a major impediment to the development of the sector. The strategy emphasizes the need to identify and promote the removal of the main obstacles to MSME growth, as well as to encourage the development of strong business associations. In 2004, the Board began to examine the Bank's MSME policy with a view to renewing it in 2005, to reflect lessons learned and the changing external environment.

In 2004, the Bank established, with the EU, a €60-million program under their joint SME finance facility specifically to bridge a gap in finance in rural areas of the EU accession countries. The new "Rural Sub-Window" will help address the inability of many agricultural businesses and rural enterprises to obtain adequate short- or long-term finance by extending loans and strengthening the capacity of local financial intermediaries.

In 2004, the EBRD continued its strong focus on supporting credit lines for SMEs through financial intermediaries in its countries of operations. Since the Bank's first small business program was established in 1994, more than 800,000 loans worth more than €4.0 billion have been disbursed to small and micro businesses. In 2004, the EBRD disbursed 329,000 loans for small and micro enterprises, totalling roughly €1.5 billion.

Activities in the Financial Sector

Financial Sector Policy—The EBRD's financial sector policy takes a country-specific approach to financial sector development, focusing on the need to promote confidence and competition in an independent financial system. The EBRD seeks to strengthen confidence in the sector primarily by helping to improve local institutions' governance and business practices. It also tries to improve financial supervision and regulation, although its activities here are constrained by its investor role in the sector and potential concerns about

conflict of interest. Nonetheless, as a reputable foreign investor in the sector, the EBRD offers important insights on supervisory and regulatory requirements, which it shares with other international financial institutions operating in the region and with governments. To address competition and independence, EBRD investments attempt to increase the diversity of institutions and services available (particularly to the private sector and SMEs), facilitate foreign direct investment and strengthen the commercial orientation of state-owned financial institutions, particularly in preparation for privatization.

In 2004, the EBRD committed €1.5 billion in financing to financial sector operations, representing 36 per cent of the EBRD's business volume in 2004.

Banking Sector Activities—In 2004, the EBRD signed new loans valued at €858.9 million to the banking sector, and signed equity transactions worth €197.3 million. In most cases where the EBRD holds an equity stake in a local financial institution, it is represented on the supervisory board of the institution, where it promotes management accountability, good corporate governance, sound banking practices, and appropriate environmental reviews and procedures. Participation in bank privatizations is a key factor behind equity investments in early and intermediate transition countries.

Non-Bank Financial Institutions—During 2004, the EBRD continued its support of the non-bank financial sector. New commitments of €72 million were made under the EBRD's micro and small enterprise program. The EBRD is one of the largest financial investors in this sector, with investments in local asset management and mutual fund companies becoming increasingly important as voluntary pension sectors in the Bank's countries of operations develop. By the end of 2004, the Bank had investments in the non-bank financial sector in most of the countries in the region, where necessary institutional and regulatory regimes had been or were in the process of being introduced. The EBRD also committed €174 million to insurance companies, leasing companies and specialist mortgage lending institutions in 2004, mainly in advanced transition countries.

Environment

Under its establishing Articles, the EBRD is explicitly committed to ensuring the environmental sustainability of all its projects. By investing in projects that reduce waste and pollution, the EBRD plays an important role in improving environmental standards in borrowing countries. EBRD projects have focused on upgrading municipal wastewater plants and improving energy efficiency by upgrading power generation and distribution systems. The EBRD is also assisting borrowing countries to comply with EU environmental standards. It also works with commercial financial institutions in borrowing countries to increase the profile of environmental issues in their lending policies.

In 2003, the Bank adopted a new Environmental Policy, which covers occupational health and safety issues as well as core labour standards, and expanded its public consultation process and information disclosure with respect to project environmental impact assessments. In November 2004, the

EBRD published its first annual *Environmental Report*, covering the Bank's 2003 operations. The report emphasizes the role of public consultations in ensuring a project's sustainability, and highlighted the extensive public consultations the Bank undertook in the Caucasus and in London before signing the Baku-Tbilisi-Ceyhan pipeline project. It also discusses the EBRD's contributions to reducing the emissions of greenhouse gases, including the work undertaken with the Dutch government to establish one of Europe's first carbon trading funds. Created in October 2003, the Carbon Credit Fund will invest in climate-friendly projects that reduce greenhouse gas emissions from Central Europe to Russia and Ukraine. The report also notes that the EBRD is in discussion with other countries about the establishment of similar funds.

Apart from the initiatives to specifically redress environmental weaknesses, many EBRD projects include environmental targets—for example, to reduce atmospheric emissions and industrial wastewater discharges and promote waste recovery, recycling and clean technologies. The EBRD contributes to international initiatives such as the "Environment for Europe" process, including the Environmental Action Plan for Central and Eastern Europe, the Danube River Basin Strategic Action Plan, the Helsinki Commission and the Global Environment Facility, for which it is an executing agency.

In 2004, the EBRD did not approve any projects for support under the Northern Dimension Environmental Partnership (NDEP), although the pipeline for 2005 is strong. The NDEP[8] provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on the environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol. Canada became an official contributor to the NDEP Support Fund at the end of 2003 and has committed €20 million to the "nuclear window." This contribution made Canada the NDEP's sole non-European contributor. Canada's contribution counts towards its commitment to the G-8 Global Partnership program. To deal with nuclear waste, the NDEP provides full funding within an international cooperation framework designed to address the complex challenges of cleaning up the legacy of the former Soviet navy's Northern Fleet. In 2004, on the nuclear side, the Assembly approved in principle eight priority measures, for which the EBRD is expected to develop financing proposals early in 2005.

[8] NDEP members include Russia, the EBRD, the EU, the Nordic Investment Bank, Canada, Denmark, Finland, France, Germany, the Netherlands, Norway, Sweden and the UK.

The EBRD applies environmental due diligence to all its investment and technical cooperation operations. Project sponsors are required by the Bank to undertake environmental impact assessments, analyses and audits that address potential environmental, health and safety, and socio-economic impacts of projects. Environmental impact assessments and analyses are conducted when potential impacts are significant. Environmental audits are performed post-approval. In some cases, both an audit and an assessment/analysis are performed. The EBRD also requires local financial intermediaries, through which it channels funds to micro, small and medium-sized enterprises, to adopt appropriate environmental policies and procedures.

Municipal and Environmental Infrastructure

EBRD investments in this sector focus on upgrading local facilities, such as municipal wastewater treatment plants, and on raising the service levels of municipal and local utility companies. Reducing costs and increasing the reliability of municipal services can stimulate the development of commercial and industrial enterprises. At the same time, greater access to clean water and sanitation services improves public health and increases public confidence in the transition process and ongoing reform efforts.

Over the last few years, the EBRD has increasingly relied on municipal, as opposed to national, guarantees in this sector, providing local governments with important new financial opportunities and responsibilities. The EBRD's operations policy for municipal and environmental infrastructure emphasizes private sector involvement, the development of appropriate regulatory structures, and improvements in energy efficiency.

As discussed above, the EBRD dedicated part of its 2004 *Transition Report* to a discussion of the challenges and emerging trends in infrastructure services. In 2004, the EBRD provided financing of more than €216 million to projects designed to improve municipal infrastructure and promote energy efficiency.

Energy Sector Investments

Most of the EBRD's countries of operations suffer from severe economic and environmental problems caused by polluting energy systems and inefficient energy pricing. Under its Energy Operations Policy, the Bank promotes energy efficiency through its operations. One of the policy's key objectives is to improve environmental performance, including meeting climate change objectives and supporting renewable forms of energy. The Bank began consultations in 2004 on a new energy policy to update and consolidate its existing Energy Operations and Natural Resources Operations Policies.

The EBRD and Nuclear Safety

Through the Nuclear Safety Account (NSA), 15 donors, including Canada and other Group of Seven (G-7) countries, have continued to work closely with the EBRD to improve nuclear safety in countries of Central and Southeastern Europe and in the former Soviet Union. The NSA is used primarily for making essential safety improvements to older-generation, Soviet-built reactors and to help Ukraine cope with the aftermath of Chernobyl. Total contributions to the NSA are approximately €280 million.

The Bank has continued to administer the Chernobyl Shelter Fund for securing the sarcophagus around the Unit IV reactor in Ukraine (which was destroyed by nuclear accident). The G-7 nations, the EU and other countries have pledged US$716 million (of the original estimate of US$768 million), of which Canada has pledged US$33 million. In 2003, the conceptual design for the new shelter was completed and the overall cost estimated at approximately US$1.1 billion. The construction work on the stabilization of the sarcophagus started in 2004, and the proposals for the detailed design and construction of the new shelter are under evaluation with the contract award planned for the first half of 2005. The project is expected to be completed by the end of 2008, but requires up to US$300 million in additional funds. The G-7/EU are currently discussing financing for up to US$200 million of the shortfall.

Three International Decommissioning Support Funds created in 2000 are operational. They were put in place to assist with the decommissioning of potentially unsafe nuclear reactors in Lithuania (Ignalina Units 1 and 2), the Slovak Republic (Bohunice VI Units 1 and 2) and Bulgaria (Kozluduy Units 1–4).

Discussions between the EBRD and the government of Ukraine on financing for the completion of the Khmelnitsky Unit 2 and Rovno Unit 4 (K2R4) nuclear reactors were concluded in 2004, and EBRD financing of US$42 million was approved in July. Since Ukraine had already completed the K2R4 reactors on its own, the EBRD project's scope is narrower than initially planned and helps finance the post–start-up component of the safety modernization program that will bring the reactors up to international safety standards.

In 2004, the Bank approved a total of US$170 million for two Caspian gas projects: the development of the Shah Deniz gas field and the South Caucasus Gas Pipeline. The pipeline will be built along the route of the Baku-Tbilisi-Ceyhan oil pipeline, a major project developed in cooperation with the World Bank Group and for which the Bank approved financing in 2003. This new EBRD loan is expected to foster improved business and environmental standards at the local partner level and underpin initiatives to ensure transparency and monitoring of project revenues that are so important in the economic development of Azerbaijan, one of the poorest countries in the EBRD's region of operations. The two projects will mean increased, dependable access to gas as a source of energy for Azerbaijan and Georgia, and diversification of supply in the Caucasus.

Addressing Corruption and Poor Governance

The transition countries, like most emerging economies, face significant challenges in improving transparency and governance. As required by its statutes (Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development), the Bank reviews on an annual basis each country's progress towards multi-party democracy, pluralism and a market economy. These principles—which Canada fully supports and encourages—contribute to transparency in public policy making and act as a check on corruption.

From this standpoint, the domestic policies of Belarus, Turkmenistan and Uzbekistan continue to raise concerns as they are difficult to reconcile with the political and economic conditions set out in Article 1 of the Bank's Articles of Agreement. The Bank's country strategies for Belarus and Turkmenistan were renewed in 2004 and, in recognition of these concerns, link the level and nature of the Bank's involvement to the extent of improvement in the political and economic situation. Given the lack of reform progress, these countries continue to be excluded from direct EBRD investments in the state sector. The 2003 strategy for Uzbekistan, reflecting serious concerns, set out seven political and economic benchmarks for reform and scheduled a progress review for the spring of 2004. After monitoring developments over the year, in April 2004, the Bank concluded that very limited progress had been made and decided to restrict its activities to private sector operations and those public sector projects that either finance cross-border activities or clearly benefit the Uzbek people. As part of the regular country strategy updates, the strategy for Uzbekistan will be updated in the summer of 2005.

To a large degree, the EBRD seeks to enhance good governance and transparency in its countries of operations through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the boards of directors of companies in which it invests has been instrumental in improving the transparency of their accounting and business practices and their respect for minority shareholder rights. It is hoped that the success of these companies will demonstrate the importance of applying similar practices more broadly in the region. In addition, all Bank business partners are examined to ensure they meet the highest standards of business practice. The Bank routinely seeks the services of forensic accountants and specialized firms to perform integrity checks on companies in which it might invest and on their management and shareholders. For those doing business with the EBRD, the EBRD's procurement policies and rules set the standards of ethics and conduct required during the procurement and execution of EBRD-financed projects.

The Bank's work in the area of legal transition also supports these goals. Under its Legal Transition Programme, the Bank has worked to improve the legal environment in its countries of operations by advancing legal reform in six areas: bankruptcy, company law/corporate governance, concessions, financial market regulation, secured transactions and telecommunications. In addition, the Bank has participated in international standard-setting efforts,

including the World Bank Insolvency Initiative, which seeks to develop international principles of bankruptcy, and the Financial Stability Forum's efforts to coordinate the development and implementation of international financial standards. The Bank also initiated a project with the Russian Federal Commission for the Securities Market to develop a Corporate Governance Code and helped the CIS Inter-Parliamentary Assembly draft a model securities law. To promote transparency the EBRD publishes an annual survey of the extensiveness and effectiveness of various commercial laws in the region in its legal journal, *Law in Transition*. In 2004, the EBRD introduced a new tool, known as a country law assessment, that evaluates core commercial laws using international standards as a benchmark and assesses how laws actually work in practice, drawing on the views of local lawyers working in private practice.

Enhancing Institutional Transparency, Accountability and Governance

The EBRD's Public Information Policy is based on the presumption that information about Bank activities should be made public in the absence of a compelling reason for confidentiality. The following documents are available to the public, with commercially sensitive information deleted as required: draft sectoral policies (for public comment); final sectoral policies; Board-approved country strategies following consultation with the country concerned; summaries of medium- and long-term operational strategies; executive summaries of environmental impact assessments for public and private sector projects; and reports on public sector projects (on a request basis). The Bank's policy requires management to report annually to the Board on the implementation of the Public Information Policy. These findings are made available on the Bank's Web site.

The Bank's Public Information Policy was reviewed and revised in 2003 to enhance transparency and to expand communications with stakeholders. In July 2004, the Bank launched its Independent Recourse Mechanism (IRM), a set of procedures providing for independent review of complaints about Bank-financed projects. The IRM has the mandate to resolve complaints concerning Bank compliance with its own policies. This is in addition to the Manager of Outreach/NGO Relations, who serves as a point of contact between the Bank and the NGO (non-governmental organization) community. The IRM gives local groups, who may be directly and adversely affected by Bank activities, a means of addressing grievances to the Bank—and evaluates whether the Bank has acted in line with its own policies. It includes a problem-solving function to encourage or restore dialogue between parties in an effort to resolve the underlying issues giving rise to a complaint.

To be accountable to its shareholders and its stakeholders, the EBRD evaluates its projects, usually within two years after full disbursement, to assess the extent to which the projects have met their objectives. In 2004, 88 per cent of the Bank's approved projects received a transition impact potential rating of "Good" or "Excellent." From 2005 onwards, the expected

transition impact rating—that is, transition potential adjusted by risk—will be part of the Bank's institutional scorecard.

As part of the international effort to combat the financing of terrorist activities, the Bank adheres to internationally coordinated controls on the illegal use of funds. This includes extensive checks on the integrity of potential clients and monitoring levels of corruption in countries of operations.

Canada has encouraged these policy initiatives. In all international financial institutions (IFIs) in which it is a member, Canada has been at the forefront of efforts to enhance transparency and accountability.

Encouraging Partnerships

The EBRD is required by its founding agreement to involve outside sources of financing in its operations. The Bank plays a key role in attracting co-financiers that might not otherwise be willing to invest in the region. Co-financing has the benefit of increasing a country's access to international capital markets, promoting foreign direct investment and allowing appropriate risk sharing. The EBRD's main co-financing partners are commercial banks, government agencies, export credit agencies and other IFIs. In 2004, the EBRD worked in partnership with commercial banks and other private lenders to achieve a dramatic increase in total co-financing volume, achieving a record commercial co-financing amount of €3.5 billion.

The EBRD also works with donor countries to provide financing for institution building and technical cooperation. Such funding has played a significant role in promoting transition. In 2004, total donor funding received was €82 million and is increasingly used for supporting enhancements to the investment climate in the region. Canada was the sixth largest donor in 2004, with €2.4 million of Canadian technical cooperation funding used for EBRD commitments (projects identified and initiated). Where possible, the EBRD also works with other IFIs in order to extend the impact of the Bank's financing and to benefit from complementarities with the other institutions. In 2004, the EBRD worked with other IFIs on projects involving €682 million in co-financing. Key partners for the EBRD included the International Finance Corporation and the European Investment Bank. Total co-financing from all partners was €5.4 billion in 2004.

Canada has encouraged this cooperation and coordination among multilateral development banks and is pleased with the efforts of the EBRD to work more closely with its sister institutions.

Human Resources

At end of December 2004, the EBRD had regular staff of 965 at its headquarters, unchanged from 2003. Locally hired staff in the Bank's Resident Offices totalled 237, up from 229 in 2003. There are approximately twice as many male professional staff as female professional staff.

Canadian Priorities in 2004

Canada is a strong supporter of the Bank's medium-term operational priorities, which are premised on: the central importance of creating and strengthening those institutions that ensure markets work well; the key role that small businesses can play in creating dynamic, competitive and more equitable economies; and the relevance to the transition process of the Bank's mandate to support countries committed to and applying the principles of multi-party democracy and pluralism.

To achieve these priorities going forward, Canada continues to support the Bank's focus on:

- promoting transparency and accountability in public sector management;
- developing sound financial sectors linked to the needs of enterprises and households;
- providing leadership for the development of micro lending and SMEs;
- developing market-based and commercially oriented infrastructure;
- demonstrating, through selected examples, effective approaches to restructuring viable large enterprises;
- taking an active approach in its equity investments to improve corporate governance;
- engaging governments in policy dialogue to strengthen institutions and improve the investment climate;
- taking a regional approach where appropriate; and
- promoting sustainable development and environmental due diligence.

The EBRD is the only multilateral financial institution that has an explicit requirement that its members be committed to and apply principles of multi-party democracy and pluralism. Canada fully supports this requirement and believes it is appropriate for the Bank to limit its participation in those countries where commitment to the principles embodied in Article 1 is very weak.

Promoting a multilateral rules-based trading system is also a key Canadian priority, and many of the Bank's activities work to support the integration of the transition countries into the world trading system.

The EBRD is committed to working closely and cooperatively with other IFIs and donors in the region. Canada strongly supports this approach. Coordination with other IFIs and donors is an important determinant of the EBRD's effectiveness in promoting the transition to a market economy. Further, the role of other IFIs in addressing poverty directly can complement the EBRD's work in the region.

Managing Canada's Interests

Role of Governors—The highest authority in the Bank is the Board of Governors. A Governor and an Alternate Governor represent each member country. The Honourable Ralph Goodale, Minister of Finance, is the Canadian Governor and Mr. Peter Harder, Deputy Minister of Foreign Affairs, is the Alternate Governor.

Role of the Board of Directors—The Board of Directors, which is responsible for the general operations of the Bank, is composed of 23 members, of which four are non-European members. Canada is the third largest non-European shareholder, after the United States and Japan, and by virtue of its share has the right to elect its own Director. Canada also represents Morocco at the Bank. The Canadian Director is Mr. Scott Clark. The Minister (Economic/Commercial) at the Canadian High Commission in London, Mr. David Plunkett, is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

Role of Canadian Government Departments—Within the Canadian government, responsibility for oversight of the EBRD's activities resides with the International Policy and Institutions Division of the Department of Finance. In consultation with the Department of Foreign Affairs, the Department of International Trade and the Canadian International Development Agency (CIDA), the Department of Finance regularly reviews the Bank's policy papers and proposed country strategies and provides advice to the Canadian Director.

Functions of the Canadian Director—In addition to participating in regular Board meetings, the Canadian Director is currently a member of the Board of Directors' Budget and Administrative Affairs Committee, which monitors efficiency, cost control and budgetary prudence, oversees the Bank's human resources policies (including those relating to governance and ethics), and ensures that the Bank's resources are directed towards its priorities. The Canadian Director was an active member of the Audit Committee in 2004, until the Board Committees' memberships were renewed. The Canadian Director continues to participate actively in Audit Committee meetings as well as those of the Financial and Operations Policies Committee.

Positions Taken in 2004—The Canadian Director has frequently spoken to the Board on the importance of the Bank's charter requirement that member countries be committed to market reform and multi-party democracy. In 2004, Canada's Director spoke on the need to address issues related to the disregard for human rights and democratic principles, and actively supported the decision to restrict the Bank's operations in Uzbekistan. Canada's Director also spoke strongly on the need to rigorously apply the additionality test for projects in EU-accession countries and stressed the importance of the Bank's goal of shifting operations to the south and east to early and intermediate transition economies.

To ensure EBRD operations are additional (i.e. the Bank's Articles stipulate that the EBRD should not displace financing available from the private sector on reasonable terms) and contribute to the transition process, Canada continued to advocate increased Bank efforts to find sound projects in countries that are in the early and intermediate stages of transition, that respect the principles of multi-party democracy, and are making efforts at reform. Only by focusing on quality projects will the Bank contribute to advancing transition in these countries. In the advanced transition countries, Canada has insisted on the need for Bank financing to be additional. Therefore Canada has urged the Bank to be increasingly focused and strategic in the advanced transition countries, where private sector financial and capital markets are increasingly active. The Canadian Director abstained from supporting several projects in 2004, due to a lack of additionality.

Canada has also been a strong proponent of greater EBRD transparency, accountability to shareholders and improved internal governance, believing that the Bank should be a model of behaviour for the region.

Canadian Staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2004, there were 25 Canadian professionals on the staff of the EBRD, representing 3.9 per cent of total professional positions, in line with Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that Canadians fill the following positions: Director of Communications, Director of the Procurement Department and Director of the Early Transition Countries Initiative.

Canada's Voting Record

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board. As a result, decisions at the Board are generally taken by consensus. Directors may, however, abstain or vote against projects in consultation with their constituencies. The Canadian Director abstained or voted against the following policies and projects in 2004:

- On the grounds of a lack of additionality: a €15-million loan to PKP Energetyka, an electricity supplier in Poland; a €350-million loan to Slovenske Elektrarne, the Slovak Republic's state-owned electricity generation utility; a €50-million regional facility in favour of Wienerberger AG, a brick and pipe manufacturer; an equity investment of €11.2 million to Uniqua Biztositó, an insurance company in Hungary; and a US$90-million loan to the Russian Standard Bank, the country's pioneer consumer finance institution.
- A €20-million loan in favour of Celsa Huta Ostrowiec, a steel producer in Poland, and a US$35-million loan to ISTIL, a private steel mill in Ukraine, because of concerns about the global overcapacity in the steel industry.
- An €8-million equity investment in International Moscow Bank (IMB), over concerns about an apparent conflict of interest between the Russian central bank's role as both a regulator and shareholder of IMB.

Canadian Commercial Interests

The EBRD offers a number of investment opportunities for Canadian businesses and financial institutions. The objectives of the Canadian Office are to increase Canadian awareness of these investment opportunities, explain how the Bank's financing mechanisms work, and ensure that EBRD policies and procedures are followed in a transparent and fair manner.

To achieve these objectives, the Canadian Office provides EBRD market information and intelligence to Canadian firms and advises Canadian project sponsors on EBRD financing options. In addition, the office develops commercial co-financing opportunities with Export Development Canada and other Canadian financial institutions. Together with the Departments of Foreign Affairs, International Trade and Industry, the office also identifies EBRD procurement opportunities and, with CIDA, promotes Canadian technical cooperation activities and official co-financing with the EBRD.

In 2004, there was one new investment in the region with Canadian sponsor involvement. The EBRD provided a US$10-million loan to Chelopech Mining EAD for environmental remediation, refurbishment and modernization and expansion of the Chelopech mine and processing plant in Bulgaria. Chelopech Mining EAD is 100 per cent owned by Dundee Precious Metals Inc., a public company traded on the Toronto Stock Exchange. In addition, the Board approved EBRD support for Project Vltava through participation of up to €50 million in a bond issue by Cesky Mobil, the third largest mobile phone operator in the Czech Republic. The bond issue will be up to €450 million and will allow Cesky Mobil to upgrade its network to 3G technology. The project was sponsored by a Canadian company, Telesystem International Wireless.

In 2004, 16 contracts that totalled €2.2 million were awarded to Canadian consultants for project preparation, project implementation, and investment climate reform support in the transportation, financial institutions, environment, natural resources, and legal reform sectors. The majority of these assignments were funded through Canadian technical cooperation (TC) funds.

Canada has approved €1.5 million over five years for the EBRD's TurnAround Management Programme, to be used to hire retired and semi-retired Canadians to work as advisors to SMEs in EBRD countries of operations. In 2004, five assignments worth €446,500 were initiated to assist companies in Georgia, Tajikistan, Russia, and Serbia and Montenegro. Under Canada's Phase V EBRD Trust Fund, five new TC assignments were approved by CIDA totalling €1.1 million: two in the Kyrgyz Republic and one each in Russia, Ukraine and Moldova. These assignments were initiated to assist with reforms in the road sector, the aviation industry, standards setting, the deposit insurance industry, pension privatization, and telecommunications. In Southeastern Europe, Canada approved 13 TC assignments under the Canada South East Europe Fund totalling €2.7 million—including five in Serbia and Montenegro, two regional, and one each in Bosnia and Herzegovina, Bulgaria, Albania, Croatia, FYR Macedonia and Romania. The assignments

covered legal reform, transportation, municipal and environmental infrastructure, and financial institutions, including SME credit training. In 2004, Canada also approved a new untied C$2-million fund in the Caucasus and Central Asia that will focus on projects in Baku-Tbilisi-Ceyhan, Tajikistan and Georgia. This new fund supports the Bank's Early Transition Countries Initiative.

Since January 1, 2004, Canada no longer funds technical cooperation assignments in the Central European countries that acceded to the EU in 2004.

In 2005, CIDA and the EBRD will continue to work to align their technical cooperation activities more closely with CIDA programming priorities.

On the commercial co-financing side, Cordiant Capital of Montréal (formerly known as International Finance Pension Trust), has co-financed 15 transactions with the EBRD since 2002, ranking as the EBRD's 10th largest co-financing partner. In 2004, Cordiant participated in 9 EBRD transactions, including a very innovative involvement with a microbank in Ukraine, and the development of its first euro fund.

Looking forward, the EBRD hopes to increase the number of high-quality Canadian project sponsors with whom it invests to better align its official co-financing and technical cooperation needs with Canadian interests in the region, and to strengthen its partnership with Export Development Canada and other Canadian commercial co-financiers.

Promoting Canada's Interests

Members of the Canadian Office made a number of visits to Canada and the EBRD's countries of operations in 2004 to meet with business people, conduct seminars, speak at conferences and consult with government officials. A highlight for the year was the June investor outreach visit to Toronto and Montréal, where the Canadian Director and the EBRD President met with representatives of the Canadian business and investment communities to explain the role of the EBRD and showcase opportunities for Canadian companies.

The following events in 2004 supported by the Canadian Director's office also promoted Canada's interests:

- The EBRD Private Public Partnership Specialist on the Municipal and Environmental Industries Team participated in GLOBE 2004 in Vancouver on April 1, including an Export Development Canada (EDC) roundtable.
- Canadian government officials and business representatives attended the EBRD Annual Meeting in London, England, on April 18–19.
- The Business Advisor for the Canadian Director's office participated in CIDA/Canadian Manufacturers and Exporters sponsored International Development Days in Calgary, April 21–23—including presentations and one-on-one meetings. The Business Advisor met with approximately 30 individuals and companies expressing interest in the region.
- The EBRD's Deputy Head of the Bulgaria office participated in the EDC/Foreign Affairs Bulgarian Business Opportunities Event, held in Montréal on April 29.
- In June, EBRD President Jean Lemierre, Canadian Director Scott Clark, and Business Advisor Sandy Ferguson made an investment promotion visit to Canada. President Lemierre was the keynote speaker at the Conférence de Montréal. The group also had meetings with private sector firms interested in investment in the region in both Montréal and Toronto. This event received excellent media coverage in both the French- and English-language national papers.
- The Business Advisor participated in the Montréal World Trade Centre and partners outreach "Doing Business with Multilateral Development Banks," Sept.14–17 in Montréal, Toronto and Fredericton.
- An EBRD representative for the Trade Facilitation Programme participated in the Ontario Exports Financing seminar on October 14.
- The EBRD's Director of Policy Studies from the Chief Economist's Office and Advisor travelled in December to Ottawa to present to business, academics and government officials key findings of the Bank's 2004 *Transition Report* on developments in the business and economic environments of the Bank's countries of operations.

Members of the Canadian Director's Office in London met with approximately 95 Canadians in 2004, including business people, representatives of financial intermediaries, parliamentarians, representatives from all levels of government, non-governmental organization representatives, consultants and academics.

Challenges Ahead

There were some spectacular developments in the region in 2004, including the accession of eight EBRD countries of operations to the EU in May and the election in Ukraine at year-end. These events are key transition successes.The success of EU accession suggests that the transition to democracy and market economies is all but complete in the new EU countries. In particular, these countries are increasingly able to obtain private sector financing. In the short term, this means that the Bank's activities must increasingly be focused on those areas that represent real additionality and have sufficient transition impact to warrant the use of Bank resources. In the medium term, the transition successes in the EU accession countries—as well as those in the EU candidatures of Romania, Bulgaria and Croatia—elevate the question of the EBRD's Graduation Policy and the future of the Bank itself. These fundamental questions will form the backdrop of the work being done in 2005 for the next Capital Resources Review, which Bank Governors will consider in 2006.

In Russia, high oil prices continue to support high GDP growth, but this also underscores the economy's vulnerability to fluctuations in oil prices and, similar to other resource-rich CIS countries, delays necessary reforms. Priority needs to be given to promoting investment in a wide range of sectors, including the financial sector, and encouraging improved investment climates. In the early transition countries, and to a lesser extent the intermediate transition ones, the challenge continues to be to find quality projects in a high-risk environment that is characterized by a lack of market-supporting institutions. The Bank's new Early Transition Countries Initiative provides a platform for increasing both the effectiveness and the volume of its activities in these countries. The Bank must continue to work in close partnership with other international financial institutions. Expanded cooperation will also be necessary to develop high-transition impact projects with explicit social and poverty alleviation benefits in order to strengthen the willingness of governments in some of the least advanced transition economies to move forward with politically difficult but essential reforms, particularly the restructuring or closure of large state-owned enterprises.

The transition experience of the Bank provides clear lessons for the future. Commitment to market-oriented economic and democratic political reforms along with sound fiscal policies are a prerequisite for sustained economic growth and access to international capital markets, which provide the foundation for further transition successes. Although the relationship between reform and growth is complex, and other factors allow some countries to delay reform while continuing to grow, transition is deepest in those countries that have made progress on economic and democratic reforms. In these economies, market-supporting institutions have tended to develop. These institutional frameworks—predictable fiscal and regulatory environments, secure property rights, an impartial judiciary and sound financial supervision and regulation—combined with commitment to democratic principles, have transformed their citizens' opportunities.

In contrast, in some countries in the Bank's region of operation, particularly those further east, progress in putting in place the institutions that underpin a market economy has been limited, and the process of liberalization and privatization is far from complete. As a result, economic growth remains vulnerable to external and internal shocks. In addition, the significant increase in poverty and inequality since the start of transition has eroded support for necessary reforms in many countries. Overcoming resistance to reform will be a challenge; it will require creating new employment opportunities and social fallback options for those displaced by structural change, and breaking the hold of powerful vested interests over the reform process.

Good governance will continue to play a critical role in the future success of the region and, in this regard, the EBRD will need to find ways to conduct its business to promote its Article 1 commitment to the principles of multi-party democracy and pluralism. In particular, the Bank will continue to monitor the progress of Belarus, Turkmenistan and Uzbekistan. The Bank's financing in Belarus and Turkemenistan is strictly limited to the private sector. As for Uzbekistan, the Board of Directors will revisit its country strategy in the summer of 2005, and will be looking for evidence of progress towards the EBRD's political and economic benchmarks. Given the lack of progress in Uzbekistan since April 2004, the new strategy will likely reflect the existing approach. Canada will continue its vigorous support for Bank efforts to address issues related to the rule of law, human rights and democratic principles.

Good corporate governance will also figure prominently in the period ahead, and the EBRD will need to continue to promote sound institutions, more efficient tax collection and improved legal and regulatory frameworks. It must ensure not only that appropriate legislation is developed, but also that it is properly implemented and enforced.

Finally, good governance within the EBRD itself is also important. Since the EBRD, as a multilateral institution, is not regulated, the Bank must ensure that it adopts and maintains the highest industry standards. To this end, in 2004, the Bank started work on a formal Certification of Internal Controls procedure with the aim of establishing the system by the start of 2005. The formal certification of financial controls will ensure the presence and effectiveness of internal controls, helping to identify and minimize risks. The procedure known as COSO, which was developed in the United States in recent years, is being widely adopted by corporate America, especially in the wake of the Sarbanes-Oxley legislation. COSO is also used by the World Bank. In addition, in 2004, the Board reviewed and renewed the terms of reference for the Bank's Audit Committee. Reviews of the Terms of Reference of the other two Board committees also began in 2004, as did review of the EBRD's Code of Conduct, to ensure they are all in line with best practices; these reviews will be completed in 2005.

Contacting the Office of the Director for Canada

The Canadian Director's office at the EBRD may be reached at:

Office of the Director for Canada and Morocco
European Bank for Reconstruction and Development
One Exchange Square, Room 8.15
London, EC2A 2JN
United Kingdom

Mr. C. Scott Clark, Director	Tel: +44 20 7338 6457
Mr. David Plunkett, Alternate Director[1]	Tel: +44 20 7338 6507
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[1] Resident at the Canadian High Commission in London.

[2] Responsible for policy matters.

[3] Responsible for business development and investor liaison.

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (such as *Financing With the EBRD*), special reports (such as the *Annual Report* and *Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's Web site:

http://www.ebrd.com/

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom
(Fax: +44 20 7338 7544)

Annex 1
The Bank's Financial Activities

The Bank's financial activities are divided into ordinary and special operations, depending on the source of funds. Ordinary operations are financed from the ordinary capital resources of the Bank, which comprise subscribed capital, market borrowings, and income from loans and investments. Special operations are those financed by "special funds" for specially designated purposes that are typically outside the Bank's regular activities. Unlike other regional development banks, the EBRD does not operate a concessional or "soft" loan window.

Ordinary Capital Resources

At the end of 2004, the total authorized capital of the Bank was €20 billion. Canada has subscribed to 3.4 per cent—or €680 million (C$958 million)—of the Bank's authorized capital. Canadian contributions to the Bank's capital are made in US dollars (at a pre-determined euro/US$ exchange rate).

In 2004, Canada made its seventh purchase of shares under the first capital increase (which came into effect on April 3, 1997, and doubled the initial €10-billion capital base). Under the first capital increase, 77.5 per cent of Canada's share is "callable," meaning that the Bank can request these resources in the unlikely event that it requires them to meet its financial obligations to bondholders; the balance, or 22.5 per cent, is "paid-in." Payments are being made in eight equal annual installments (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). The following table details Canadian payments to the Bank in US dollars.

Canada's contributions to the Bank's capital are non-budgetary expenditures because our shares in the Bank represent an asset. Nonetheless, Canada's paid-in contributions to the Bank do increase the Government's financing requirements.

Canadian Payments to the EBRD

Year	Notes	Cash	Encashment of notes	Total cash outlay
		(in US dollars)		
1991	11,903,502	11,903,502	11,903,502	23,807,004
1992	11,903,502	11,903,502	3,967,834	15,871,336
1993	11,903,502	11,903,502	7,935,668	19,839,170
1994	11,903,502	11,903,502	11,903,502	23,807,004
1995	11,903,502	11,903,502	11,903,502	23,807,004
1996	–	–	7,935,668	7,935,668
1997	–	–	3,967,334	3,967,334
1998	7,287,199	4,858,132	1,457,439	6,315,572
1999	7,287,199	4,858,132	2,914,878	7,773,010
2000	7,287,199	4,858,132	4,372,317	9,230,449
2001	7,287,199	4,858,132	5,829,759	10,687,891
2002	7,287,199	4,858,132	7,287,198	12,145,331
2003	7,287,199	4,858,132	7,287,199	12,145,331
2004	7,287,199	4,858,132	7,287,199	12,145,331
Total	110,527,903	93,524,434	95,953,503	189,477,937

Market Borrowings

At the end of 2004, total EBRD borrowings stood at €12.2 billion with an average remaining life of 8.3 years at an average cost of funds of LIBOR (London Inter-Bank Offered Rate) minus 34 basis points. Funds have been swapped into floating-rate instruments, primarily in US dollars and euros.

Standard & Poor's has assigned the Bank an AAA long-term and A1+ short-term credit rating. Moody's Investors Service has similarly rated the EBRD long-term bonds AAA.

Special Funds

The EBRD administers a number of bilateral and multilateral technical assistance funds. Canada has contributed to the following special funds:

Canadian Technical Cooperation Fund—The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects across a wide range of sectors and EBRD countries of operation. Canada has contributed C$12.65 million since the fund was established in 1992 and is currently completing Canada Phase V.

Chernobyl Shelter Fund—The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this 10-year project is roughly US$1.1 billion, of which US$716 million has been pledged so far. Canada has pledged US$33 million, including US$0.8 million of bilateral assistance for ventilation stack repair.

Nuclear Safety Account (NSA)—This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operations until the plants can be closed. The NSA complements other bilateral and multilateral nuclear safety technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of €280 million. Canada's contribution has been completely disbursed.

Russia Small Business Fund (RSBF)—The purpose of this fund is to establish a facility for small business finance and micro lending in various regions of Russia. The RSBF was established in 1993 as a pilot project and became permanent in 1995. Canada has contributed C$11.3 million towards the US$300-million fund.

CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE)—By 2002, Canada had contributed C$10 million in support of the EBRD's South Eastern Europe Action Plan, to be used for technical cooperation and co-financing activities. These funds, tied to Canadian consultants, were used in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, and Serbia and Montenegro. In 2003, an additional C$6 million was added to the CFSEE, which focuses on CIDA priority sectors and countries of focus.

CIDA-EBRD Balkan Region Special Fund (BRSF)—In addition to the CFSEE, Canada has contributed C$2 million to the Balkan Region Special Fund to support post-conflict reconstruction efforts in the Balkan region.

TurnAround Management (TAM) Programme—The TurnAround Management Programme was established in 1993 to match senior industrial advisors from market-driven economies with chief executives of selected firms in the region. The objective is to provide industrial management know-how and develop business skills so that these companies can become competitive and profitable. In 2003, Canada signed a new agreement with the TAM Programme to provide C$2.5 million over five years to be used to hire Canadians to work as advisors. This brought Canada's total contribution to the TAM Programme to C$3.05 million.

Ukraine Micro Finance Bank (MFB)—In 2000, Canada entered into a contribution agreement with the EBRD to provide C$1.25 million for the provision of technical assistance related to the development of the MFB. Over three years, Canada has assisted the MFB to develop a branch network throughout Ukraine, with special attention being paid to Slavutych, the community where many former employees of the Chernobyl nuclear power plant reside. As a greenfield operation specializing in financial services for the micro and small enterprise sector, the MFB is also serving as a demonstration bank for the Ukrainian commercial banking sector to show the commercial viability of micro and small enterprise lending.

Technical Assistance in Support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II—Between 1999 and 2004, Canada provided C$3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. The technical assistance has included risk- and loan-evaluation training.

Northern Dimension Environmental Partnership (NDEP)—NDEP provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on the environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol. Canada became an official contributor to the NDEP Support Fund at the end of 2003 and has committed €20 million. This made Canada the NDEP's sole non-European contributor. Canada earmarked its contribution for the facility's "nuclear window," which counts towards Canada's commitment to the G-8 Global Partnership program. To deal with nuclear waste, the NDEP provides full funding within an international cooperation framework designed to address the complex challenges of cleaning up the legacy of the former Soviet navy's Northern Fleet. In this regard, the NDEP completed a Strategic Master Plan in 2004 that has been adopted by all contributors as the basis for projects in the nuclear window.

CIDA-EBRD Cooperation Fund for Central Asia and the South Caucasus—This C$2-million fund was created in 2004 for work on project preparation and implementation activities in Central Asia and the South Caucasus. The fund targets the following sectors: agribusiness, natural resources, infrastructure financing (e.g. transport, telecommunications, municipal finance), and strengthening institutional capacity development of local institutions working in private sector development and micro-lending institutions. Given CIDA's program focus, priority will be given to projects in Georgia and Tajikistan. This is the first Canadian bilateral fund at the EBRD that is untied (i.e. procurements are not limited to Canadians).

Annex 2
Doing Business With the EBRD

For general information, please refer to www.infoexport.gc.ca/ifinet or contact the Bank's Communications Department in London (tel: +44 20 7338 6096; fax: +44 20 7448 6690).

Further inquiries should be directed to the Office of the Director for Canada, Advisor for Business Development and Investor Relations, Ms. Sandy Ferguson (tel: +44 20 7338 6509; e-mail: fergusos@ebrd.com).

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with the EBRD are requested to direct initial inquiries either to the Office of the Director for Canada, to the Project Inquiries in London (tel: +44 20 7338 6282 or +44 20 7338 6252; fax: +44 20 7338 6102) or to the Bank's resident office in the country of operation. Summaries of EBRD private sector operations can be obtained on the Bank's Web site at http://www.ebrd.com/.

Canadian Suppliers of Goods and Works: The EBRD makes available information on all stages of public sector project development, from the point a project has been identified by the Bank through to its approval. Procurement opportunities and co-financing notices, as well as contract awards information, can be accessed on the Bank's Web site free of charge (see address above).

Canadian Consultants: The EBRD's Web site contains technical cooperation notifications and invitations for expressions of interest for consultancy services pertaining to both public and private sector projects. The EBRD is currently working on an e-Procurement initiative expected to be launched in 2005. This initiative will involve the selection of consultants through a Web-based process.

Current procurement information can be found at http://www.ebrd.com/oppor/procure/index.htm

Individual Canadians: The EBRD maintains a recruitment section on its Web site, which provides information on specific employment competitions at the Bank as they become available. In general, applications for employment for permanent positions and summer jobs should be sent to:

Paolo Gallo, Director for Human Resources
Human Resources Management Department
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

ANNEX 3

EBRD MEMBERSHIP AS AT DECEMBER 31, 2004

	Share of the Bank's capital (%)
European Members	
Austria	2.28
Belgium	2.28
Cyprus	0.10
Denmark	1.20
Finland	1.25
France	8.52
Germany	8.52
Greece	0.65
Iceland	0.10
Ireland	0.30
Israel	0.65
Italy	8.52
Liechtenstein	0.02
Luxembourg	0.20
Malta	0.01
Netherlands	2.48
Norway	1.25
Portugal	0.42
Spain	3.40
Sweden	2.28
Switzerland	2.28
Turkey	1.15
United Kingdom	8.52
European Union	3.00
European Investment Bank	3.00
Non-European Members	
Australia	0.50
Canada	**3.40**
Egypt	0.10
Japan	8.52
Korea, Republic of	1.00
Mexico	0.15
Mongolia	0.01
Morocco	0.05
New Zealand	0.05
United States	10.00

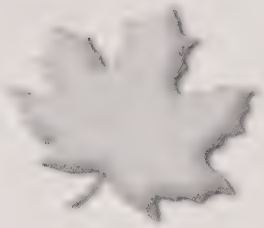
	Share of the Bank's capital (%)
Countries of Operations	
Albania	0.10
Armenia	0.05
Azerbaijan	0.10
Belarus	0.20
Bosnia and Herzegovina	0.17
Bulgaria	0.79
Croatia	0.36
Czech Republic	0.85
Estonia	0.10
FYR Macedonia	0.07
Georgia	0.10
Hungary	0.79
Kazakhstan	0.23
Kyrgyz Republic	0.10
Latvia	0.10
Lithuania	0.10
Moldova	0.10
Poland	1.28
Romania	0.48
Russia	4.00
Serbia and Montenegro	0.47
Slovak Republic	0.43
Slovenia	0.21
Tajikistan	0.10
Turkmenistan	0.01
Ukraine	0.80
Uzbekistan	0.21



Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

2005

Canada



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2005

Prepared by:
International Trade and Finance Branch
April 2006

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Introduction

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aims are to foster the transition towards open, market-oriented economies in Central and Southeastern Europe, as well as in the successor states of the former Soviet Union,[1] and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multi-party democracy, pluralism and a market economy (see Annex 3 for a list of the EBRD's 27 countries of operations).

The EBRD differs from other multilateral development banks in four ways. First, its overriding focus is the private sector and support for the transition from central planning to stable market economies. Its charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. Second, it has a particular focus on the promotion of democratic institutions and human rights in its countries of operations. Third, while all multilateral development banks are committed to ensuring the environmental sustainability of their projects, the EBRD is the only such institution where this commitment is explicitly written into its Articles of Agreement. Fourth, the EBRD does not provide concessional financing.

The Bank seeks to help its 27 countries of operations to implement structural and sectoral economic reforms, taking into account the particular needs of countries at different stages in the transition process. In particular, its private sector activities focus mainly on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD has 62 members: 60 countries, the European Union (EU) and the European Investment Bank (see Annex 3 for a list of members).

Canada is the eighth largest shareholder (tied with Spain), following the other Group of Eight (G8) countries. Canada's formal participation is authorized under the European Bank for Reconstruction and Development Agreement Act, which was promulgated in February 1991. Article 7 of the Act states that:

> The Minister [of Finance] shall cause to be laid before each House of Parliament by March 31 of each year or, if that House is not then sitting, on any of the thirty days next thereafter that it is sitting, a report of operations for the previous calendar year, containing a general summary of all actions taken under the authority of this Act, including their sustainable development aspects within the meaning of Article 2 of the Agreement, and their human rights aspects.

This report responds to this requirement and reviews the activities and operations of the Bank for the year 2005.

[1] In 2004, Governors voted to make Mongolia a country of operations, recognizing its close linkage with the former Soviet economy and its long history with a centrally planned economy. This process will be complete once all members formally accept Mongolia as a country of operations; this is expected to occur in 2006.

Benefits of Membership

As a major trading nation, Canada has a stake in global peace and stability, which the successful integration of Central and Southeastern Europe and the former Soviet Union into the world economy and global institutions helps to promote. By fostering continued political and economic reform in the region, the EBRD is contributing to its integration into the world economy and to its stability.

The Minister of Finance is Canada's representative on the Board of Governors at the Bank and nominates a Director to its 23-member Board. This representation allows Canada to have high-level influence on decisions taken by the EBRD on investments in the region and on policies to move countries through the transition process. The EBRD also provides trade opportunities for the Canadian private sector, supporting a diversification of international markets for Canadian businesses.

Details on Canada's financial contributions to the EBRD are provided in Annex 1.

The EBRD

- fosters the transition of former centrally planned economies of Central and Southeastern Europe and the successor states of the former Soviet Union towards market-oriented economies;
- promotes private entrepreneurial initiative by targeting at least 60 per cent of its resources to private sector projects, with the balance in support of commercially viable state sector projects that promote private sector development;
- operates only in countries committed to applying the principles of multi-party democracy, pluralism and market economics;
- promotes environmentally sound and sustainable development; and
- operates on a self-financing basis.

Role and Mandate of the EBRD

The EBRD's operations to advance the transition to a market economy are guided by three principles: maximizing transition impact, additionality, and sound banking. Financing is provided for projects that expand and improve markets, help to build the institutions necessary for underpinning a market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also be additional to other sources of financing and not displace them, further ensuring that the Bank contributes to the transition process. Finally, Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers attractive returns. Adherence to sound banking principles also helps to ensure the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector.

In promoting economic transition in its countries of operations, the Bank acts as a catalyst for increased flows of financing to the private sector. The capital requirements of these countries cannot be fully met by official multilateral or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the central Asian republics. By providing an umbrella under which wider funding for private sector investment can be assembled, the EBRD plays a catalytic role in mobilizing capital. In 2005, for every euro the EBRD invested, it mobilized an additional 1.5 euros from the private sector and other multilateral and bilateral agencies.[2]

The Bank's medium-term operational priorities are premised on: the key role that the private sector can play in creating dynamic, competitive and more equitable economies; and the relevance to the transition process of the Bank's mandate to support countries committed to and applying the principles of multi-party democracy and pluralism.

To achieve these priorities the Bank focuses on:

- taking an active approach in its equity investments to improve corporate governance;
- developing sound financial sectors linked to the needs of enterprises;
- providing leadership for the development of lending to micro, small and medium-sized enterprises;
- developing market-based and commercially oriented infrastructure;
- demonstrating, effective approaches to restructuring viable large enterprises;
- engaging governments in policy dialogue to strengthen institutions and improve the investment climate;
- promoting transparency and accountability in public sector management;
- taking a regional approach where appropriate; and
- promoting sustainable development and environmental due diligence.

[2] On December 31, 2005, one euro purchased 1.3803 Canadian dollars.

Operational Environment in 2005

The transition countries experienced strong macroeconomic performance in 2005 with an average growth rate of 5.3 per cent, down from 6.6 per cent in 2004. Growth in 2005 was supported by domestic demand and, to a lesser extent, net exports. Rapid expansion in domestic credit sustained consumption and investment, but in many instances it widened external imbalances.

Strong growth in domestic demand, which underpinned growth across the transition region, was fuelled by a rapid expansion in domestic credit to the private sector. Much of this expansion reflected the increase in financial services that accompanies economic development and convergence with the full-fledged financial systems of advanced economies. Cyclical factors and possibly temporary gains in asset valuations also played a role.

The transition countries made progress in structural and institutional reform in 2005. Market improvements in Central and Eastern Europe, following EU accession in May 2004, were driven largely by favourable market responses to recent progress in strengthening financial institutions. Advances in some countries in the Commonwealth of Independent States (CIS),[3] meanwhile, followed significant political change. There was, however, a slowdown in the pace of reform in much of Southeastern Europe.[4] This reflected not only continuing political uncertainty but also a pre-EU-accession pause in reform by candidate countries. Russia was the only transition country to see some transition reversal, given the effective renationalization of large private companies in the oil and gas sector (e.g. Gazprom, selected Yukos Oil Company assets).

Russia

Russian economic growth is estimated to have slowed to 6.0 per cent in 2005 from 7.2 per cent in 2004 due to lower growth in oil extraction and exports and slow progress in structural reforms. Although high oil and gas prices helped boost the Russian economy, the economy remains overly reliant on these sectors and is therefore vulnerable to negative price shocks. The federal budget continued to benefit from high oil prices, registering a surplus of close to 7 per cent of gross domestic product (GDP). The Oil Stabilization Fund, which increased substantially to nearly US$80 billion by end-2005, was used to prepay US$15 billion of Paris Club debt. Further early debt repayments are planned for 2006. Inflation was 10.9 per cent in 2005, slightly below the revised target range of 11–11.5 per cent.

[3] The CIS includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

[4] Southeastern Europe includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia (FYR Macedonia), Romania, and Serbia and Montenegro.

Other CIS Countries

Growth in the other CIS countries remained strong in 2005 at 6.2 per cent, following growth of 7.9 per cent in 2004. Growth was supported by high commodity prices (particularly for oil and gas but also for metals and agricultural products) and strong domestic demand. Despite the moderation of growth, the outlook remains generally favourable due to the continued strength of oil prices. The most significant slowdown was in Ukraine, where growth fell to 4.0 per cent in 2005 from 12.1 per cent in 2004. This is due to a sharp drop in external demand for its steel and a decrease in investment given uncertainty over the business and political environment.

Central Europe[5]

In 2005, average growth in Central Europe fell to 4.2 per cent from 5.1 per cent in 2004, reflecting the curtailment of investment and export subsidies. In particular, growth in Poland slowed to 3.5 per cent from 5.4 per cent. The Czech Republic was the only country in the region to post higher growth in 2005 (5.0 per cent) than in 2004 (4.4 per cent). The Baltic countries continued to register strong growth in 2005, led by Latvia, which grew by 7.5 per cent.

Southeastern Europe

The maintenance of political stability, further progress with structural reforms and the prospect of EU accession for Bulgaria, Croatia and Romania continue to support growth. Bulgaria and Romania have set 2007 as their indicative date for accession, while Croatia does not have an indicative date, as it only began accession negotiations in October 2005. Average GDP growth in Southeastern Europe was 4.8 per cent in 2005, moderating from 6.5 per cent in 2004. Growth in Bulgaria (5.5 per cent), Croatia (3.5 per cent) and Romania (5.5 per cent) has been driven primarily by private consumption, fuelled by rapid credit growth with the further development of banking systems. Investment has been driven by EU-accession expectations, ongoing privatizations and lower inflation and, in the case of Romania, capital account liberalization leading to sharp reductions in interest rates.

[5] Includes the Czech Republic, Hungary, Poland, the Slovak Republic, Slovenia and the three Baltic States (Estonia, Latvia and Lithuania).

Transition Report for 2005

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition from a centrally planned to a market economy in each of the Bank's 27 countries of operations. The *Transition Report* is recognized as the leading publication analyzing the progress of transition in the former Soviet bloc. The 2005 report focused on the theme of "Business in Transition", specifically examining the changes in transition countries' business environments. Drawing on the third round of the joint World Bank-EBRD Business Environment and Enterprise Performance Survey, the report argued that substantial progress has been achieved in Central Europe: markets have responded favourably to ongoing reforms. In the CIS, nascent political change has provided benefits to the private sector in a number of countries. In almost all areas of the transition region, the business environment has improved steadily as a whole; specifically, most countries have shown improvements in their approaches to regulation, taxation, the judiciary, and crime and corruption.

While the business environment has improved on average, barriers to business are still much greater in transition countries than in mature market economies. The survey notes that the costs of business regulation, poor-quality institutions, weak property rights and an unstable macroeconomic environment all remain major obstacles to businesses in transition countries. Dynamic firms such as private start-ups are the most severely affected. The report also shows that the business environment is not static for firms in any given country. Geographic analysis shows that firms in remote areas face more obstacles than do those in major cities. In addition, the type of ownership has substantial impacts on businesses: foreign-owned and new private firms tend to be more efficient than privatized and state-owned enterprises. The report also notes that the shortcomings in the business environment have hindered enterprise growth, but that other factors such as competition must be addressed in order to improve firms' overall level of efficiency and their responsiveness to change.

Financial Results for 2005

In 2005, the EBRD realized a very strong financial performance with profits after provisions of €1.5 billion, far above last year's figure of €402 million.[6] This particularly strong performance was due to profits from major equity exits as well as unrealized gains from the movement in the fair value of the Bank's associate share investments and high-risk equity funds, both of which are variable by nature. The EBRD continued to see a reduction in its impaired assets (non-performing loans) in 2005. At the end of 2005, the Bank had impaired loans totalling €35 million, compared to €86 million at the end of 2004.

[6] The 2004 financial results have been restated in accordance with International Financial Reporting Standards requirements, reflecting accounting changes made by the Bank in 2005.

Progress in Transition in EBRD Countries of Operations

			Enterprises			Markets and trade			Financial institutions		Infra-structure
Countries	Population (millions, mid-2005)	Private sector share of GDP in %, mid-2005 (EBRD estimate)	Large-scale privatization	Small-scale privatization	Governance and enterprise restructuring	Price liberal-ization	Trade and foreign exchange system	Compe-tition policy	Banking reform and interest rate liberalization	Securities markets and non-bank financial institutions	Infra-structure reform
Albania	3.2	75	3	4	2	4+	4+	2	3-	2-	2
Armenia	3.2	75	4-↑	4	2+	4+	4+	2+↑	3-↑	2	2+
Azerbaijan	8.3	60	2	4-	2+	4	4⇑	2	2+	2-	2
Belarus	9.8	25	1	2+	1	3-	2+	2	2-	2	1+
Bosnia and Herzegovina	3.8	55↑	3-↑	3	2	4	4-	1	3-	2-	2+
Bulgaria	7.8	75	4	4-	3-	4+	4+	3-↑	4-	2+	3
Croatia	4.4	60	3+	4+	3	4	4+	2+	4	3-	3
Czech Republic	10.3	80	4	4+	3+	4+	4+	3	4↑	4-↑	3+
Estonia	1.4	80	4	4+	4-↑	4+	4+	3-	4	3+	3+
FYR Macedonia	2.0	65	3+	4	2+	4	4+	2	3-	2	2
Georgia	4.6	65	4-↑	4	2+↑	4+	4+	2	3-	2-	2+
Hungary	10.0	80	4	4+	4-↑	4+	4+	3	4	4↑	4-
Kazakhstan	15.1	65	3	4	2	4	3+	2	3	2+	2+
Kyrgyz Republic	5.1	75	4-	4	2	4+	4+	2	2+	2	2-
Latvia	2.3	70	4-	4+	3	4+	4+	3-	4-	3	3
Lithuania	3.4	75	4↑	4+	3	4+	4+	3	4-↑	3	3-
Moldova	3.4	60↑	3	3+	2↑	4-	4+	2	3-	2	2+↑
Poland	38.2	75	3+	4+	4-↑	4+	4+	3	4-↑	4-	3+
Romania	21.7	70	4-	4-	2+↑	4+	4+	2+	3	2	3+
Russia	144.9	65↓	3↓	4	2+	4	3+	2+	2+↑	3-	3-
Serbia and Montenegro	8.3	55↑	3-↑	3+	2+↑	4	4-↑	1	3-↑	2	2
Slovak Republic	5.4	80	4	4+	4-↑	4+	4+	3	4-	3-	3-
Slovenia	2.0	65	3	4+	3	4	4+	3-	3+	3-	3
Tajikistan	6.5	50	2+	4↑	2-	4-	3+	2-	2	1	1+
Turkmenistan	6.5	25	1	2	1	3-	1	1	1	1	1
Ukraine	47.3	65	3	4	2	4	3+↑	2+	3-↑	2+	2
Uzbekistan	26.0	45	3-	3	2-	3-	2↑	2-	2-	2	2-

Note: The classification of transition indicators uses a scale from 1 to 4, where 1 implies little or no progress with reform and 4 implies a market economy. A rating of 4+ indicates the country has achieved standards and performance typical of advanced industrial economies. ↑ and ↓ arrows indicate change from the previous year. One arrow indicates a movement of one point (from 4 to 4+, for example).

Source: EBRD, 2005 *Transition Report.*

Financial Highlights

- The Bank recorded €4.3 billion of new operations in 2005, an increase of approximately €200 million from 2004. Of this amount, 58 per cent was approved for early and intermediate transition economies in the former Soviet Union and Southeastern Europe. Another 26 per cent went to Russia, and the remaining 16 per cent went to the advanced transition countries of Central Europe.[7]
- As the institution reports its financial results in euros, the appreciation of the US dollar in 2005 increased the euro value of EBRD operations, given that many of its operations, and especially those in CIS countries, are transacted in US dollars.
- Profits after provisions were €1.5 billion, the highest in the Bank's history and markedly higher than previous years. This record profit includes the volatile contribution made by unrealized gains from unsold share investments.
- Total provisions on banking assets were €352 million, down from €540 million at the end of 2004. This is due to an accounting change, following which the EBRD no longer places provisions on its equity holdings, as equity is marked-to-market.
- Gross disbursements, at €2.2 billion, were in line with normal levels but declined from 2004, a year that witnessed a 60-per-cent increase.
- The Bank mobilized €1.5 in additional financing for every euro that it invested in 2005, down from €2.1 in 2004. This is due to the large number of state infrastructure projects signed by the Bank, as well as the absence of large private natural resource transactions, which typically mobilize significant amounts of private investment.
- The private sector share of annual business volume was 76 per cent, down from the 86 per cent reported in 2004. This is primarily due to the large number of state infrastructure projects signed by the Bank in 2005.
- Administrative expenses were within budget at €224.6 million in 2005.
- Reserves[8] at the end of 2005 were €4.7 billion, up sharply from €1.7 billion (restated) at the end of 2004, primarily reflecting large net profits for the year and an increase in the fair value of the Bank's non-associate share investments. €2.5 billion of the Bank's reserves represent unrealized gains from share investments and Treasury assets.

[7] The advanced transition countries include Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. The early transition countries are the Bank's seven poorest countries of operations: Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan. The intermediate transition countries include the balance of the EBRD's countries of operations, excluding Russia. The EBRD considers Russia to be in a category of its own.

[8] Reserves are Bank capital set aside to cover unexpected losses.

The EBRD approved 151 projects in 2005, up from 129 the previous year. Along with investments under frameworks, these commitments totalled €4.3 billion, up from €4.1 billion in 2004, surpassing the base case target of €3.8 billion. Net cumulative commitments by the end of 2005 amounted to €16.8 billion. The level of disbursements, at €2.2 billion, fell off sharply from 2004, reflecting a significant decrease in average disbursement size, but the level was nevertheless in line with previous years (2004 saw an increase of 60 per cent relative to 2003). As a result of decreasing disbursements and rising reflows, the latter particularly in more advanced transition countries, operating asset growth was checked, though the Bank's portfolio continued to grow. The geographic composition of business volume and reflows in 2005 resulted in the portfolio share of early and intermediate transition countries reaching 47 per cent by year-end. Guarantees increased to €229 million from €180 million at the end of 2004.

The overall financial performance for 2005 and growing reserves indicate that even as the Bank increases its emphasis on the early and intermediate transition countries—where the investment climate is particularly risky—it continues to follow sound banking principles.

Institutional Developments

Early Transition Countries Initiative

2005 marked the first full year of the EBRD's Early Transition Countries (ETC) Initiative, and it was a successful year. The Initiative, which covers the seven ETCs (Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan), aims to boost the EBRD's investment and impact in these countries by using a streamlined approach, developing new instruments to meet local needs (including smaller projects), mobilizing more investment and encouraging ongoing economic reform. Since the Initiative began, the number of new operations in ETCs has risen substantially, and the Bank's business volume, portfolio and project pipeline development have responded similarly. The number of operations financed in 2005 almost doubled from a year earlier, reaching 61, and the corresponding level of commitments was over 2.5 times higher, at around €250 million. (These figures exclude transactions in the oil and gas sector as well as under the EBRD's Trade Facilitation Programme.) Similar sizable increases were noted in the first, albeit incomplete, year of the Initiative.

Key to the Initiative's success is the ETC Multi-Donor (ETCMD) Fund, which was established as a key pillar of the Initiative and to which Canada contributed €500,000. The Fund—the first EBRD fund to which bilateral donors' contributions are classified as Official Development Assistance—supports project preparation, implementation and capacity-strengthening initiatives, enabling the Bank to make investments in these countries. Given the Bank and donors' positive experience with the overall Initiative, efforts and pledges to replenish the Fund began in 2005.

The Bank continues to work on refining its approach in ETCs in order to increase its reach and effectiveness. Reflecting the Bank's comparative advantages, however, the Initiative continues to emphasize private sector development, particularly in micro, small and medium-sized enterprises. It thus plays a key role in supporting activities that ensure sustainable solutions to poverty alleviation. The Initiative also promotes financing of smaller government infrastructure investments appropriate to local consumers' ability to pay for improvements in these services (e.g. water, heating). ETCMD Fund donors' push for greater emphasis on results-based management and gender equality in this Initiative should pave the way for a transformative impact on the Bank's overall operations.

To parallel the successful ETC Initiative, the Bank has indicated to donors that it is considering setting up a dedicated Western Balkans Fund. The decade-long isolation from international markets due to political developments in the Western Balkans, compounded by macroeconomic instability, has caused severe difficulties for the region's transition. Most enterprises are operating at very low levels of capacity, export business is poor and the very high unemployment rate is a key social and economic issue. Over the coming year, the Bank will assess with donors whether to proceed with this proposed Fund.

Private Sector Development

Fostering the development of strong private sectors in its countries of operations is an essential element of the EBRD's strategy for promoting the transition to a market economy. A strong small and medium-sized enterprise (SME) sector is an important means of developing a "constituency for reform" in the transition economies that can act as a counterweight to powerful vested interests that benefit from weak state governance. The Bank's Articles stipulate that it commit at least 60 per cent of its portfolio to private sector activities, both globally and in individual countries. The global portfolio ratio requirement was first satisfied in 1994 and was 76 per cent in 2005.

A core part of the EBRD's work with the private sector is its support of micro, small and medium-sized enterprises (MSMEs), which are important engines for job creation and growth, and therefore poverty reduction. The Bank's strategy for the MSME sector is founded on three pillars: financing, improving the investment climate through policy dialogue and developing business support networks for MSMEs. The strategy explicitly recognizes that the poor investment climate, and not just limited access to financing, is a major impediment to the development of the sector. The strategy emphasizes the need to identify and promote the removal of the main obstacles to MSME growth, develop proper financial instruments for MSME support and encourage the development of strong business associations.

With a view to ensuring the Bank remains at the forefront of MSME financing, the Bank drafted a new strategy in 2005 and sought public input. The draft strategy proposes that the Bank's main delivery channel for MSME products continue to be its wide network of relationships with established financial institutions. The draft strategy envisages further expanding this network by working with non-bank financial institutions, as well as developing greenfield microfinance institutions. Looking ahead, the new strategy will be sensitive to the individual needs of each country of operations, taking into account their varying levels of transition, the strength of the private sector and existing MSME programs. The new strategy is expected to be adopted by the Board in early 2006.

In 2005, the EBRD continued its strong focus on supporting credit lines for MSMEs through financial intermediaries in its countries of operations. Since the Bank's first small business program was established in 1994, more than 1.26 million loans worth more than €6.9 billion have been disbursed to small and micro businesses. In 2005, the EBRD disbursed 480,000 loans for small and micro enterprises, totalling roughly €2.5 billion.

Financial Sector Activities

Financial Sector Policy—The EBRD's financial sector policy takes a country-specific approach to financial sector development, focusing on the need to promote confidence and competition in an independent financial system. The EBRD seeks to strengthen confidence in the sector primarily by helping to improve local institutions' governance and business practices. It also tries to improve financial supervision and regulation, although its activities here are constrained by its investor role in the sector and potential concerns about conflict of interest. Nonetheless, as a reputable foreign investor in the sector, the EBRD offers important insights on supervisory and regulatory requirements, which it shares with other international financial institutions operating in the region and with governments. To address competition and independence, EBRD investments attempt to increase the diversity of institutions and services available (particularly to the private sector and SMEs), facilitate foreign direct investment and strengthen the commercial orientation of state-owned financial institutions, particularly in preparation for privatization.

In 2005, the EBRD committed €1.4 billion in financing to financial sector operations, representing 34 per cent of the EBRD's business volume in 2005.

Banking Sector Activities—In 2005, the EBRD signed new loans valued at €796.7 million to the banking sector, and signed bank equity transactions worth €94.6 million. In most cases where the EBRD holds an equity stake in a local financial institution, it is represented on the supervisory board of the institution, where it promotes management accountability, good corporate governance, sound banking practices, and appropriate environmental reviews and procedures. Participation in bank privatizations is a key factor behind equity investments in early and intermediate transition countries.

Non-Bank Financial Institutions—During 2005, the EBRD continued its support of the non-bank financial sector. The EBRD is one of the largest financial investors in this sector in its countries of operations, with investments in local asset management and mutual fund companies becoming increasingly important as voluntary pension sectors in the Bank's countries of operations develop. Through 2005, the Bank has maintained investments in the non-bank financial sector in most of the countries in the region, where necessary institutional and regulatory regimes had been or were in the process of being introduced. The EBRD also committed €196.1 million to insurance companies, leasing companies and specialist mortgage lending institutions in 2005, mainly in advanced transition countries.

Capital Market Development—The EBRD's mandate includes fostering transition through measures to stimulate the development of local capital markets. One of the Bank's approaches to capital market development involves working with authorities to develop the legal framework for the issuing of long-term local currency bonds. Since 1999, the Bank has been working closely with the Russian authorities, including through the provision of extensive advice and technical assistance on the new Securities Market Law that was passed by the Duma in December 2003. This law permitted international issuers for the first time to raise funds in the domestic capital market. The EBRD also worked closely with Russia's National Currency Association (NCA) to develop a new and transparent money market index, the Moscow Prime Offered Rate (MosPrime Rate). This cooperation with Russian authorities and the NCA led to the launch of the first bond by an international issuer in the Russian domestic market, an EBRD five-year ruble bond issue on May 18, 2005. This bond is also the first floating-rate note made possible by the creation of the transparent and credible MosPrime benchmark rate to which it is indexed. The EBRD bond is listed on the government bond section of the Moscow Interbank Currency Exchange and has been approved for use in repo transactions with the Central Bank of Russia, enhancing their use as a liquidity management tool.

This path-breaking transaction has had a significant impact on the development of the Russian capital market by introducing a new asset class and by opening the door to other international issuers. In addition to making possible the issuance of floating-rate bonds by other international and domestic issuers, the newly established MosPrime Rate will provide a benchmark for the local market for bank loans, contributing to greater pricing transparency and consistency. The bond issue will also benefit the companies and businesses in Russia that are potential clients of the EBRD. Until now, the Bank's clients have been unable to access long-term ruble funds based on a reliable market-based rate, but rather have had to rely on hard currency borrowing to match the maturity of their funding and returns from their long-term investments. However, this has exposed some clients to foreign exchange risks to the extent that they are not hedged by revenues denominated in or linked to hard currencies such as the US dollar or euro. The proceeds from the EBRD's ruble bond will be used to provide long-term funding for companies that produce or provide services primarily for the Russian market, including small and medium-sized enterprises and municipalities, thereby allowing them to better manage their liabilities and avoid exchange rate risk.

As demand for ruble loans is strong, the Bank will look to revisit the Russian bond market in 2006, although new regulatory changes will need to be reversed prior to re-entry. The Bank is also working with the local authorities in a number of other countries (e.g. Bulgaria, Kazakhstan, Romania and Ukraine) with a view of issuing other local currency bonds in the next year or two.

Environment

Under its Articles of Agreement, the EBRD is explicitly committed to promoting environmentally sound and sustainable development in its activities. By investing in projects that reduce waste and pollution, the EBRD plays an important role in improving environmental standards in borrowing countries. The Bank's projects have focused on upgrading municipal wastewater plants and improving energy efficiency by upgrading power generation and distribution systems. The EBRD also assists borrowing countries to comply with EU environmental standards and works with commercial financial institutions in borrowing countries to increase the profile of environmental issues in their lending policies. The term "environment" is broadly defined in the Bank's Environmental Policy to include occupational health and safety, public health, labour and other social issues.

Apart from the initiatives to specifically redress environmental liability issues, many EBRD projects identify environmental opportunities, including environmental targets—for example, to reduce atmospheric emissions and industrial wastewater discharges and promote waste recovery, recycling and clean technologies.

The EBRD contributes to international initiatives such as the Environment for Europe process, including the Environmental Action Plan for Central and Eastern Europe, the Danube River Basin Strategic Action Plan, the Helsinki Commission and the Global Environment Facility, for which it is an executing agency. And within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on the environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol.

The Northern Dimension Environmental Partnership (NDEP)[9] provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Canada became an official contributor to the NDEP Support Fund at the end of 2003 and has committed €20 million to the "nuclear window." Through this window, the first series of projects under the international effort to mitigate the legacy of the operation of nuclear-powered ships and submarines of the Northern Fleet in Russia are underway. Phase one of the Strategic Master Plan (SMP), priority identification, is completed.

[9] NDEP members include Russia, the EBRD, the EU, the Nordic Investment Bank, Canada, Denmark, Finland, France, Germany, the Netherlands, Norway, Sweden and the United Kingdom.

A Strategic Environmental Assessment of NDEP, the EBRD's first such assessment, was carried out in 2005 and it confirmed the priorities identified by the SMP. In 2005, the NDEP Assembly approved phase two of the SMP. In phase two, the Russian authorities, local experts and international consultants will form a Programme Development Team to develop an overall decommissioning programme, complete with complementary studies. An integrated programme, expected to be completed by April 2007, will serve as a tool for the Russian authorities to plan and manage long-term decommissioning activities in the region. In the interim, projects that have been identified as urgent are proceeding—the NDEP Assembly approved five such projects in 2005. These deal with improvement of storage conditions for (alpha) reactor cores in Andreeva Bay, physical protection in Gremikha Bay and installation of a radiation monitoring system in the Murmansk region. A prerequisite to project funding was also put in place in 2005. Specifically, the EBRD and the Energy Agency of Russian Federation (Rosatom) concluded an agreement on technical assistance that brings projects in the NDEP nuclear window under the cover of the Multilateral Nuclear Environmental Programme in Russia.

The EBRD applies environmental due diligence to all its investment and technical cooperation activities. Project sponsors are required by the Bank to undertake environmental impact assessments, analyses and audits that address potential environmental, health and safety, and socio-economic impacts of projects. Environmental impact assessments and analyses are conducted when potential future impacts are significant. Environmental audits are performed to identify and assess potential past impacts and liabilities. In some cases, both an audit and an assessment/analysis are performed. The EBRD also requires local financial intermediaries, through which it channels funds to micro, small and medium-sized enterprises, to adopt appropriate environmental policies and procedures.

The Bank's overarching Environmental Policy is scheduled to be reviewed in 2006. The Evaluation Department (EvD) is planning the review and subsequent revision process. While the EvD has focused on evaluation criteria, the Environmental Department (ED) has developed a system for monitoring the environmental performance of Bank projects. Implementation of an improved environmental monitoring and evaluation system is expected to take place through the course of 2006. Further, in 2005, the EvD undertook a special study that focused specifically on how the Bank achieves its environmental mandate through financial institutions. This study and other EvD findings will contribute to the ED's development of an updated Environmental Policy review. This broad approach is required to assess the Bank's and its clients' overall environmental performance, while examining the environmental change realized by individual projects.

Municipal and Environmental Infrastructure

EBRD investments in this sector focus on upgrading local utility services, such as water supply and wastewater treatment, urban transport, solid waste disposal and heating services. Modernizing service provision and its reliability stimulates the development of commercial and industrial enterprises, and provides a direct contribution to the global efforts to reduce harmful emissions. At the same time, better local services provide an immediate and tangible improvement to people's lives and also increase public confidence in the transition process and reform efforts.

The EBRD's approach in this sector supports: transition towards decentralization of service responsibilities to local or regional levels; commercialization of the operating companies providing local services, with local private sector participation where feasible/appropriate; and environmental improvement as a consequence of investments that conserve environmental resources and reduce pollution. In countries where a suitable overall legislative framework is evolving, the EBRD applies decentralized financing solutions with local (non-sovereign) government guarantees to promote adequate implementation legislation and a borrowing track record. In other countries, the Bank promotes structures that clarify ownership and corporate governance of local municipal services and support governments and donors in their efforts to establish effective, fair and transparent regulatory regimes that can attract long-term capital investment. In doing so, the Bank helps local governments introduce cost recovery and "user pay" concepts within the limits of affordability constraints and promotes transparency regarding transfers and subsidy payments.

In 2005, more than 90 per cent of EBRD local utility investments were committed without any recourse to financial guarantees by central governments, reinforcing the Bank's mandate in support of decentralization and local fiscal responsibility. Among these investments was the first non-sovereign utility transaction in an early transition country (Georgia), where the Bank is providing loan financing to Tbilisi's municipal transport company for the purchase of buses. The use of quality second-hand buses reduced the overall project costs significantly, making the service improvements affordable to the population.

The Bank's heightened interest in reducing emission levels of harmful greenhouse gases saw the extension of numerous district heating improvement loans to Romanian and Russian cities. These investments led to a 20-per-cent reduction of energy use on average, while at the same time ensuring continued heat supply to the affected population.

Investments to support improved water supply and wastewater treatment are continuing apace, with a number of major pollution hot spots removed. For example, in St. Petersburg the Bank's investment helped cut the outflow of untreated sewage by half following the October 2005 commissioning of a new treatment plant.

Energy Sector

Most of the EBRD's countries of operations suffer from severe economic and environmental problems caused by polluting energy systems and inefficient energy pricing. Thus, a key objective of the Bank's energy sector investments is to improve environmental performance, including meeting climate change objectives and supporting renewable forms of energy. The Bank is working on strengthening its impact in this area, and this push is supported by the call from G8 leaders at the 2005 Gleneagles Summit for international financial institutions (IFIs) to develop a framework to accelerate the shift to cleaner, more efficient energy production and use. The Bank is working with other IFIs to develop this framework, and in November it hosted a workshop to share its energy efficiency financing experience with other IFIs. The Bank is in the process of hiring a consultant who will review its activities in the field of climate change and make recommendations to broaden and improve its impact, thereby contributing to the formulation of the investment framework.

In addition to the Netherlands Emission Reduction Cooperation Fund, which was established in 2003, the Bank is currently developing a Multilateral Carbon Credit Fund (MCCF). The MCCF, which is expected to be launched in 2006, will be open to EBRD shareholders and private companies (though not to financial investors and traders). The MCCF will purchase project-based carbon credits as well as facilitate Green Investment Schemes (sovereign-to-sovereign sale of Assigned Amount Units). The Bank is currently discussing a possible partnership on this initiative with the European Investment Bank. The EBRD is also exploring the idea of a Sustainable Energy Cooperation Fund, which could fund energy audits and provide incentive payments in support of energy efficiency and renewable energy credit lines.

The Bank aims to promote best practices in other aspects of its energy investments as well, such as through the required adherence to the best international transparency and revenue management standards in extractive industry (e.g. oil, gas, coal) investments. In policy dialogue, the Bank encourages the adoption of the Extractive Industries Transparency Initiative (EITI)[10] in countries of operations that have not yet done so.

The Bank began consultations in 2004 on a new Energy Operations Policy to update and consolidate its existing Energy Operations and Natural Resources Operations Policies. The requisite public consultations took place in 2005, and the new Policy is expected to go to the Board for approval in 2006. The new Policy is expected to put more emphasis on social and environmental issues, including energy efficiency and climate change. For example, it is expected to target increases in the financing of energy efficiency and renewable energy projects as well as require project sponsors to enhance environmental sustainability and adopt measures designed to benefit local stakeholders where practicable. The new Policy is also expected to introduce mandatory screening of all EBRD projects for energy efficiency potential, regardless of the sector the investment is in, and to enhance monitoring and reporting systems to track its energy efficiency investments.

[10] The EITI is a voluntary initiative that supports improved governance in resource-rich countries through the full publication and verification of company payments and government revenues from oil, gas and mining.

The EBRD and Nuclear Safety

Through the Nuclear Safety Account (NSA), 15 donors, including Canada and other G7 countries, have continued to work closely with the EBRD to improve nuclear safety in countries of Central and Southeastern Europe and in the former Soviet Union. The NSA is used primarily for making essential safety improvements to older-generation, Soviet-built reactors and to help Ukraine cope with the aftermath of Chernobyl. In 2005, the NSA fell short of the amount needed to complete its work. The shortfall is estimated at US$150 million. To date, Canada has contributed approximately US$13 million to the NSA.

The Bank has continued to administer the Chernobyl Shelter Fund for securing the sarcophagus around the Unit IV reactor in Ukraine (which was destroyed by a nuclear accident). In 2004, the conceptual design for the new shelter was completed and the overall cost estimated at approximately US$1.1 billion. The G8 nations, the EU and other countries have so far contributed €645 million and pledged another €180 million in May 2005. Canada contributed US$33 million and pledged another US$7 million in 2005. The construction work on the stabilization of the sarcophagus started in 2004, and the proposals for the detailed design and construction of the new shelter are under evaluation, with the contract award planned for the first half of 2006. The project is expected to be completed by 2009.

Capital Resources Review

According to the Agreement establishing the Bank, the Board of Governors must review the Bank's capital adequacy at intervals of no more than five years. The exercise also sets out the medium-term strategy of the Bank, by defining how and where the Bank expects to operate in a manner that is consistent with its principles of transition impact, additionality and sound banking. Work on the third Capital Resources Review (CRR) began in 2005. Governors will consider the recommendations of management and the Board of Directors regarding the CRR and formally adopt it at the Bank's Annual Meeting in May 2006. More concretely, the third CRR will focus on the challenges of exiting from the eight borrowing countries that joined the EU in 2004 (EU8) as transition opportunities and the need for the Bank's financing recede, as well as renewing the Bank's business model to ensure it remains a key partner in countries where significant transition challenges remain.

The EBRD has already begun to grapple with the challenges posed by the EU8's transition success. Reflecting the region's transition progress, as well as the increased availability of commercial financing, new EBRD lending to the region continues to decline and reflows (such as early repayments) are increasing. As a result, the Bank's portfolio in the EU8 continues to shrink and has been reduced in terms of the Bank's overall portfolio. As long as the Bank's financing remains additional to address the limited transition challenges

remaining—notably financing for private sector SMEs and small and medium-sized municipalities—and projects meet the sound banking criteria, the Bank will continue to operate in the EU8. However, in the context of the third CRR and future business planning, the Bank must consider the implications of a natural withdrawal of EBRD programming in these countries.

The Bank's future lies to the south and east of the EU8. The third CRR exercise will set out how the Bank intends to continue to shift its operations towards the early and intermediate transition countries and Russia—where its impact on transition will be the greatest. This shift will concentrate the Bank's focus where the transition challenges remain the greatest and, correspondingly, where the transition and financial risks are the highest. The EBRD will continue to refine its business model to best address these challenges. The Bank's partnership with donors will continue to be an essential component of its success in fostering transition. Early in the third CRR period, the Bank should also be in a position, thanks to its strengthening reserves, to use some of its own resources to complement donor funds.

The Bank is gearing up to admit a new country of operations during the third CRR period. In January 2005, in the interest of reinforcing the Bank's transition activities, the EBRD's Board of Governors unanimously adopted a resolution aimed at admitting Mongolia as a country of operations. While Mongolia is neither a part of Central or Eastern Europe nor a former Soviet republic, it faces transition challenges similar to a number of former Soviet republics. For Mongolia to become a country of operations, all 62 of the EBRD's shareholders must accept the change in the Bank's Articles. At the end of December 2005, most shareholders had formally ratified Mongolia's admittance while the others, including Canada, expect to complete the process of acceptance by May 2006.

Another important aspect of the CRR is the Bank's Human Resources Strategy, which must ensure that the Bank is adequately staffed and has the appropriate skill mix to carry out its medium-term strategy. Given the geographical shift in the Bank's activities, this also requires adjustments to be made within the headquarter Resident Office (RO) staff allocation as well as RO consolidation. In the view of a number of member countries, including Canada, the process of RO consolidation should begin in 2007. The continued shift south and east will lead to projects that are on average smaller and more challenging due to the state of local business conditions. This implies that additional resources will be required to monitor projects to keep transition and financial performance on track. For these reasons, along with the expected increase in the number of overall projects, more resources will also be required for the Bank's internal control functions—internal audit, compliance, evaluation and risk management.

Addressing Corruption and Poor Governance

The transition countries, like most emerging economies, face significant challenges in improving transparency and governance. As required by its statutes, the Bank reviews annually each country's progress towards multi-party democracy, pluralism and a market economy. These principles—which Canada fully supports and encourages—contribute to transparency in public policy making and act as a check on corruption.

From this standpoint, the domestic policies of Belarus, Turkmenistan and Uzbekistan continue to raise concerns as they are difficult to reconcile with the political and economic conditions set out in Article 1 of the Bank's Articles of Agreement. Lack of political and economic reform has already led the Bank to reduce its operations in Belarus and Turkmenistan. In 2005, the EBRD's new two-year strategy for Uzbekistan concluded that, despite limited economic progress, no political liberalization had taken place. As a result, the Bank decided to limit its investments in Uzbekistan to the private sector, provided the investment has no direct or indirect link to the government or government officials. The Bank will focus on providing support to micro, small and medium-sized enterprises, and will continue to support international trade through its Trade Facilitation Programme. The strategies for Belarus and Turkmenistan will be renewed in 2006, but unless the countries make political and economic progress, the Bank's investments will continue to exclude public sector investments.

To a large degree, the EBRD seeks to enhance good governance and transparency in its countries of operations through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the boards of directors of companies in which it invests has been instrumental in improving the transparency of their accounting and business practices and their respect for minority shareholder rights. It is hoped that the success of these companies will demonstrate the importance of applying similar practices more broadly in the region. In addition, all Bank business partners are examined to ensure they meet the highest standards of business practice. The Bank routinely seeks the services of forensic accountants and specialized firms to perform integrity checks on companies in which it might invest and on their management and shareholders. For those doing business with the EBRD, the Bank's procurement policies and rules set the standards of ethics and conduct required during the procurement and execution of EBRD-financed projects.

The Bank's work in the area of legal transition also supports these goals. The EBRD's Legal Transition Programme helps create an investor-friendly, transparent and predictable legal environment to improve the investment climate in the Bank's countries of operations. The programme focuses on developing legal rules and establishing legal institutions as well as nurturing a culture that is essential for a vibrant market-oriented economy. Under this programme, the Bank has worked to improve the legal environment in its countries of operations by advancing reform in six areas: bankruptcy, company law/corporate governance, concessions, financial market regulation, secured

transactions and telecommunications. To promote transparency the EBRD publishes an annual survey of the extensiveness and effectiveness of various commercial laws in the region in its legal journal, *Law in Transition*. In 2005, this publication focused on "Banking Law in Transition."

Enhancing Transparency, Accountability and Governance

The EBRD's Public Information Policy is based on the presumption that information about Bank activities should be made public in the absence of a compelling reason for confidentiality. The following documents are available to the public, with commercially sensitive information deleted as required: draft sectoral policies (for public comment); final sectoral policies; Board-approved country strategies following consultation with the country concerned; summaries of medium- and long-term operational strategies; executive summaries of environmental impact assessments for public and private sector projects; and reports on public sector projects (on a request basis). The Bank's policy requires management to report annually to the Board on the implementation of the Public Information Policy. These findings are made available on the Bank's website (www.ebrd.com). Further, to ensure that the Public Information Policy serves the Bank and the public well, the Policy includes a three-year review cycle. As the current Policy was approved in 2003, it will be reviewed and renewed in 2006.

To be accountable to its shareholders and stakeholders, the EBRD assesses its contribution to the process of transition in its countries of operations. The Bank contributes to the transition process through two channels: its portfolio of projects and policy dialogue and intellectual leadership on transition and related activities, which are often but not always linked to projects. When projects are developed, the Bank assesses their potential contribution to transition. In 2005, 85 per cent of the Bank's approved projects received a transition impact potential rating of "good" or "excellent." It also assesses the projects' expected transition impact, that is, the risk-adjusted transition impact. Once a project begins, the Bank monitors the project with its Transition Impact Monitoring System; this measure helps keep bankers focused on, and working towards, the project's transition objectives. In addition, the EBRD's independent Evaluation Department evaluates the Bank's projects, usually within two years after full disbursement, to assess the extent to which the projects have met their objectives. In the context of country and sector strategies, the Evaluation Department also assesses the extent to which both transition channels have contributed towards transition.

In 2005, the Bank's Board of Directors initiated and engaged in several substantial institutional reforms to strengthen the Bank's internal governance. First, following on the renewal of the Audit Committee's terms of reference in 2004, a working group undertook a similar process of review and renewal of the terms of reference for the remaining two Board committees: the Budget and Administrative Affairs Committee and the Financial and Operations

Policies Committee. The changes reflect recent developments in corporate governance and evolving practices in other international financial institutions (IFIs). As well, the working procedures of the Board Steering Group and Board committees were updated, notably improving the transparency of the nomination process for Chairs and Vice-Chairs. 2005 also marked the first full year of the Audit Committee's new terms of reference. In discharging its new responsibilities, it reviewed the resources and work plans of the Bank's control functions—compliance, evaluation, internal audit and risk management—with a view to ensuring their effectiveness. Based on the Committee's assessment, additional funding for risk management was included in the Bank's 2006 budget. Finally, the Bank's evaluation function was given a new status, independent of management. The Evaluation Department now exclusively and directly responds to the Board of Directors, thus guaranteeing the independence of the function from operations and enhancing the Board's collective duty of accountability to the Bank's members and other stakeholders.

Canada has played a strong role in advancing these initiatives on internal governance. This is consistent with Canada's positions at other IFIs, where it has been a leader in efforts to increase transparency and accountability.

Encouraging Partnerships

The EBRD is required by its Articles of Agreement to involve outside sources of financing in its operations. The Bank plays a key role in attracting co-financiers that might not otherwise be willing to invest in the region. Co-financing with the EBRD increases a country's access to international capital markets and promotes foreign direct investment. The EBRD's main co-financing partners are commercial banks, government agencies, export credit agencies and other IFIs. In 2005, the EBRD worked in partnership with commercial banks and other private lenders to achieve a total commercial co-financing amount of €1.9 billion.

The EBRD also works with donor countries to provide financing for institution-building and technical cooperation. Such funding has played a significant role in promoting transition. In 2005, total donor funding received was €78 million and is used to support project implementation as well as enhancements to the investment climate in the region. In 2005, €4.8 million of Canadian technical cooperation funding was used for EBRD commitments (projects identified and initiated). The only donors that committed more were the Early Transition Countries Multi-Donor (ETCMD) Fund, the European Commission and the European Agency for Reconstruction. Where possible, the EBRD also works with other IFIs in order to enhance the impact of the Bank's financing and to benefit from complementarities with the other institutions. In 2005, the EBRD worked with other IFIs on projects involving €326 million in co-financing. Key partners included the International Finance Corporation and the European Investment Bank. In addition, the EBRD mobilized €338 million from official co-financing and €42 million from export credit agencies. Total co-financing from all partners was €2.6 billion in 2005.

Canada has encouraged this cooperation and coordination among multilateral development banks and is pleased with the efforts of the EBRD to work more closely with its sister institutions. Significant improvements in donor harmonization and coordination have been achieved through the recently established ETCMD Fund.

Human Resources

At end of December 2005, the EBRD had regular staff of 969 at its headquarters, largely unchanged from 2004. Locally hired staff in the Bank's Resident Offices totalled 234, again similar to 2004. There are approximately twice as many male professional staff as female professional staff at headquarters, while it is evenly split among professionals in the Bank's Resident Offices.

Managing Canada's Interests

Role of Governors—The highest authority in the Bank is the Board of Governors. A Governor and an Alternate Governor represent each member country. The Honourable James Michael Flaherty, Minister of Finance, is the Canadian Governor and Mr. Peter Harder, Deputy Minister of Foreign Affairs, is the Alternate Governor.

Role of the Board of Directors—The Board of Directors, which is responsible for the general operations of the Bank, is composed of 23 members, of which four are non-European members. Canada is the third largest non-European shareholder, after the United States and Japan, and by virtue of its share has the right to elect its own Director. Canada also represents Morocco at the Bank. The Canadian Director is Mr. Scott Clark. The Minister (Economic/Commercial) at the Canadian High Commission in London, Mr. David Plunkett, is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

Role of Canadian Government Departments—Within the Canadian Government, responsibility for oversight of the EBRD's activities resides with the International Policy and Institutions Division of the Department of Finance Canada. In consultation with Foreign Affairs Canada, International Trade Canada and the Canadian International Development Agency (CIDA), the Department of Finance Canada regularly reviews the Bank's policy papers and proposed country strategies and provides advice to the Canadian Director.

Functions of the Canadian Director—In addition to participating in regular Board meetings, the Canadian Director is currently the Chairman of the Board of Directors' Audit Committee, which oversees the integrity of the Bank's financial statements, the soundness of the Bank's system of internal controls, the ability of the control functions to perform their duties independently, and the independence, qualifications and performance of the external auditor.

The Canadian Director was actively involved as a member of the Budget and Administrative Affairs Committee in 2005, until the Board Committees' memberships were renewed. The Canadian Director continues to participate actively in Budget and Administrative Affairs Committee meetings as well as those of the Financial and Operations Policies Committee.

Positions Taken in 2005—The Canadian Director has frequently spoken to the Board on the importance of the Bank's charter requirement that member countries be committed to market reform and multi-party democracy. In 2005, Canada's Director spoke on the need to address issues related to the disregard for human rights and democratic principles, and actively supported the decision to restrict the Bank's operations in Uzbekistan. Canada's Director also spoke strongly on the need to rigorously apply the additionality test for projects in the new EU countries and stressed the importance of the Bank's goal of shifting operations to the south and east to early and intermediate transition economies.

To ensure EBRD operations are additional (i.e. do not displace financing available from the private sector on reasonable terms) and contribute to the transition process, Canada continued to advocate increased Bank efforts to find sound projects in countries that are in the early and intermediate stages of transition, respect the principles of multi-party democracy and are making efforts at reform. Only by focusing on quality projects will the Bank contribute to advancing transition in these countries. Canada has urged the Bank to be increasingly focused and strategic in the transition countries, where private sector financial and capital markets are increasingly active. The Canadian Director abstained from supporting several projects in 2005 due to a lack of additionality.

Canada has also been a strong proponent of greater EBRD transparency, accountability to shareholders and improved internal governance, believing that the Bank should be a model of behaviour for the region.

Canadian Staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2005, there were 24 Canadian professionals on the staff of the EBRD, representing 3.7 per cent of total professional positions at headquarters, in line with Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that Canadians fill the following positions: Director of Communications, Director of the Procurement Department and Director of the Early Transition Countries Initiative.

Canada's Voting Record

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board. As a result, decisions at the Board are generally taken by consensus. Directors may, however, abstain or vote against projects in consultation with their constituencies. The Canadian Director abstained or voted against the following policies and projects in 2005:

- On the grounds of a lack of additionality: a US$40-million equity investment in Novatek, Russia's largest independent gas producer; two loans totalling €50 million to Mittal Steel Company to be on-lent to its companies in Bosnia and Herzegovina and FYR Macedonia; a €90-million debt and risk-sharing extension to the EU/EBRD Municipal Finance Facility; a €10-million loan to Bucharest Municipality; and a €54-million (EBRD exposure cap) risk-sharing operation in favour of BRE Bank Hipoteczny SA, a provider of mortgage loans in Poland. The Canadian Director also questioned the incremental transition potential of the Novatek project, highlighted the issue of overcapacity in the global steel sector regarding the loans to Mittal, and expressed concern regarding the low transition potential and questionable banking arrangements regarding the EU/EBRD Facility.
- A US$8-million loan to Bayteks Ticaret, a private textiles company in Uzbekistan, because the company sources raw material from the state-controlled cotton sector and thus, in his view, is inconsistent with the new strategy for Uzbekistan. In addition, he raised concerns about forced and child labour in Uzbekistan's cotton sector. In Canada's view, this violates the Bank's Environmental Policy and creates significant integrity risks for the Bank.

Canadian Commercial Interests

The EBRD offers a number of investment opportunities for Canadian businesses and financial institutions. The objectives of the Canadian Office are to increase Canadian awareness of these investment opportunities, explain how the Bank's financing mechanisms work, and ensure that EBRD policies and procedures are followed in a transparent and fair manner.

To achieve these objectives, the Canadian Office provides EBRD market information and intelligence to Canadian firms and advises Canadian project sponsors on EBRD financing options. In addition, the office develops commercial co-financing opportunities with Export Development Canada (EDC) and other Canadian financial institutions. Together with Foreign Affairs Canada, International Trade Canada and Industry Canada, the office also identifies EBRD procurement opportunities and, with CIDA, promotes Canadian technical cooperation activities and official co-financing with the EBRD.

In 2005, there was one new investment in the region with Canadian involvement. The Bank is providing a €63-million loan to Elektrownia Patnow II, a power plant in Poland, to help finance the completion of a single 464 megawatt generating unit of replacement capacity, to replace obsolete technology with energy-efficient technology. The Bank's financing is complemented by commercial co-financing totalling €227 million, including a €42-million parallel loan from EDC. SNC Lavalin is the Canadian Engineering, Procurement and Construction contractor.

In 2005, 13 contracts totalling €3.45 million were awarded to Canadian consultants for project preparation, project implementation and investment climate reform support in the transportation, financial institutions, environment, natural resources and legal reform sectors. Eleven of these assignments were funded through five Canadian technical cooperation (TC) funds contributed by CIDA and two from Bank-funded budgets.

Under Canada's Phase IV EBRD Trust Fund, a one-year extension to the two year Insolvency Specialist Position resident in the Legal Transition Team at EBRD headquarters was approved and is expected to be contracted in early 2006. Under Canada's Phase V EBRD Trust Fund, one project was contracted for telecommunications regulatory support in the Kyrgyz Republic worth €199,845. Three new EBRD TC assignments were approved by CIDA and the Bank in 2005 covering state pension reform in Kazakhstan, investment and legal assistance for transit operations in Astana, Kazakhstan, and an EBRD gender mainstreaming study cost-shared with the UK Department for International Development. These contracts are expected to be tendered or finalized in early 2006.

In 2005, under the Canada South East Europe Fund Phase II, nine TC assignments worth €2.55 million were awarded to Canadian consultants. CIDA has identified its priorities in regional infrastructure, financial institutions, municipal and environmental industries, and environment and energy efficiency, and the assignments reflected these priorities. Three assignments were regional, covering several countries in Southeastern Europe, two were in Serbia and Montenegro, and there was one each in Albania, Bulgaria, FYR Macedonia and Romania.

In addition, Canada has a $2.5-million fund commitment for the TurnAround Management (TAM) Programme, which provides funding for Canadian retired and semi-retired business executives to act as advisors to small and medium-sized enterprises in the region. In 2005, five assignments worth $742,300 were awarded to Canadian advisors through the Canadian TAM fund, covering Armenia, Bosnia and Herzegovina and the Kyrgyz Republic. Five additional Canadian advisors were funded through other untied donor funds for TAM assignments.

Finally, the CIDA Ukraine SME Cooperation Fund expanded to include technical cooperation assistance to Ukrainian banks to expand their mortgage-lending activities.

On the commercial co-financing side, Canadians participated in nine transactions in 2005 for a total of €75 million. Cordiant Capital of Montréal has co-financed 22 transactions with the EBRD since 2002, ranking as the EBRD's ninth largest co-financing partner. In 2005, Cordiant participated in seven EBRD transactions: one in Georgia, one in Romania, three in Russia, one in Serbia and Montenegro and one with the Regional Trade Facilitation Program. In addition, EDC provided a €42-million parallel loan to the Elektrownia Patnow II power project, and Alconsult International provided €4.2 million for the Quadriga Private Equity Fund in Russia.

There are significant opportunities for suppliers in EBRD-financed public sector goods, works, supply and installation contracts. In 2005, a total of 122 public sector contracts were recorded for a value of €617 million, of which the EBRD financed €487 million. In 2005, two Canadian tenders were received though neither won a contract.

Looking forward, the EBRD hopes to increase the number of high-quality Canadian project sponsors with whom it invests to better align its official co-financing and technical cooperation needs with Canadian interests in the region, and to strengthen its partnership with EDC and other Canadian commercial co-financiers.

Promoting Canada's Interests

Members of the Canadian Office made a number of visits to Canada and the EBRD's countries of operations in 2005 to meet with business people, conduct seminars, speak at conferences and consult with government officials.

The following events in 2005 were supported by the Canadian Director's Office to promote Canada's interests:

- An outreach program to Kazakhstan, Poland, Russia and Serbia and Montenegro, brought together local companies in the region with Canadian firms to promote business opportunities. Partners in these events included the EBRD, EDC, Canadian Embassies, local business associations and senior-level government representatives. The Canadian Director and/or the Business Advisor participated in these events.
- On the Canadian outreach side, the Business Advisor participated in the annual CIDA/Canadian Manufacturers and Exporters International Development Days in Halifax. She also participated in a World Trade Centre Montréal business roundtable on doing business with the EBRD, and was joined by the EBRD's Director of Transportation and a member of the EBRD's Official Co-financing Unit. With the latter, she participated in the first Eastern Europe business forum sponsored by the Newfoundland International Trade Centre, EDC and the Newfoundland and Labrador Government in St. John's. Finally, the Canadian Office arranged to have a representative from the EBRD's Procurement Group participate in a workshop organized by the Alberta Government in Kananaskis, designed to help increase the success of Canadian tendering firms at the international financial institutions (IFIs).
- The EBRD's Lead Counsellor for Policy Studies and Sector Strategy from the Chief Economist's Office and the Canadian Policy Advisor travelled to Ottawa to present the key findings of the Bank's 2005 *Transition Report* on developments in the business and economic environments of the Bank's countries of operations to business, academics and government officials.
- The Canadian Director accompanied EBRD President Jean Lemierre to Ottawa to meet with Canadian officials, the first such visit by an EBRD President. President Lemierre met with the Minister of Finance, as well as senior Canadian government officials.
- Members of the Canadian Director's Office in London met with numerous Canadians in 2005, including business people, representatives of financial intermediaries, parliamentarians, representatives from all levels of government and non-governmental organizations, consultants and academics.

Challenges Ahead

There were many transition advancements across the region of Bank operations through 2005, particularly in the advanced transition economies of Central Europe as well as in Southeastern Europe. In addition, advanced transition economies obtained high levels of commercial financing, which resulted in another year of negative EBRD net loan disbursements to these countries, as well as a substantial drop in their share of the EBRD's financing. It is clear that the Bank's portfolio and activities will increasingly shift towards the early and intermediate transition countries and Russia, where transition challenges remain the greatest and the Bank's financing is required. The Bank's future is to the south and the east of the new EU member countries.

With this in mind, in 2005, Bank shareholders considered the institution's strategic direction in the context of its third Capital Resources Review. Work on the review will continue in 2006, and Bank Governors are expected to discuss and formally adopt it at the Bank's Annual Meeting in May 2006. The review will set out how the Bank will adapt its core banking business model to remain effective in addressing transition challenges in the increasingly complex business environment it faces. As well, it will set out how the Bank will reallocate resources efficiently and effectively to support the operational shift south and east. From a Canadian perspective, this should include consolidation of the Resident Offices in the new EU member countries, consistent with their expected market-driven graduation within the short to medium term.

The Bank's shift to early and intermediate transition countries in Southeastern Europe and the former Soviet Union is intensifying the Bank's exposure to more difficult business environments. The early and intermediate transition countries have weak institutional capacity (economic, financial and legal), which the Bank must continue to help improve through policy dialogue and the provision of technical assistance in cooperation with other stakeholders, including donor countries and other IFIs. Expanded cooperation with other IFIs will also be necessary to develop high-transition-impact projects in order to strengthen the willingness of governments in some of the least advanced transition economies to move forward with politically difficult but essential reforms, particularly the restructuring or closure of large state-owned enterprises. The Bank will also need to develop a strategy for handling increased financial risks in the medium term. The challenge going forward will be ensuring that the Bank remains focused on its core transition mandate and its operating principles of transition impact, additionality and sound banking.

An excellent example of how the Bank is meeting these challenges is its new Early Transition Countries Initiative. This Initiative provides a platform for increasing both the Bank's effectiveness and volume of activities in higher-risk markets, and enjoys the support of a multi-donor fund. It does so by streamlining its operations in early transition countries, creating new instruments to meet financing gaps and accepting more risk. The Bank will need to continue to innovate in the future while working in close partnership with other IFIs in order to address the transition gaps in these more challenging environments.

As the Bank shifts south and east, the importance of its policy dialogue role will increase. The need for strong corporate governance in all recipient countries will continue to figure as a key issue in the period ahead, and the EBRD will need to promote sound institutions, anti-corruption efforts, more efficient tax collection and improved legal and regulatory frameworks. It must ensure not only that appropriate legislation is developed, but also that it is properly implemented and enforced.

The need for the EBRD to observe its Article 1 requirement to operate only in countries committed to multi-party democracy and pluralism continues to be a challenge. While EBRD Governors have not declared any member to be in violation of the Article 1 requirement, the Board of Directors has limited operations in countries whose commitment is weak. This authority has been used in the cases of Belarus, Turkmenistan and Uzbekistan, where investments are restricted to private sector operations that can be insulated from government interference. The inclusion of Uzbekistan in this group as of July 2005 demonstrates that Article 1 principles are taken seriously by the Bank. The decision reflects the tragic events in Andijan, where hundreds of unarmed demonstrators were killed in an anti-government protest, as well as the fact that the Uzbek authorities have taken little initiative to reduce strong state control over the economy and media or to ease restrictions on opposition political parties and non-governmental organizations. Canada will continue to vigorously support Bank efforts to address issues related to the rule of law, human rights and democratic principles in all of the Bank's countries of operations.

Finally, good governance within the EBRD itself is also important. The EBRD, as a multilateral institution, is not regulated. Thus, the Bank must ensure that it adopts and maintains the highest industry standards. To this end, a number of improvements were made in 2005. The Bank introduced formal certification of internal financial controls, new terms of reference were established for the Board's committees, and the Audit Committee undertook a full review of the resource adequacy of the Bank's control functions (internal audit, compliance, evaluation and risk management). Further, evaluation at the Bank was improved as the Evaluation Department began to report directly to the Board, becoming independent from Bank management. This type of independence is considered increasingly essential to the effective operation of evaluation departments. Still, additional measures can be taken to strengthen the Bank's internal governance, ensuring that the institution's standards meet best corporate practice. In particular, the Bank needs to adopt a new Code of Conduct to replace its current one, and the role of internal audit and its organizational relationships need to be updated to reflect best practices. Work on both issues is currently underway with Board approvals to be made in 2006. Canada has played, and will continue to play, an active role in improving the Bank's internal governance.

Contacting the Office of the Director for Canada

The Canadian Director's office at the EBRD may be reached at:

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Ms. Sandy Ferguson, Advisor[3]	Tel: +44 20 7338 6509 E-mail: fergusos@ebrd.com
Ms. Alicja Krivicky, Executive Secretary	Tel: +44 20 7338 6507 E-mail: krivicka@ebrd.com Fax: +44 20 7338 6062

[1] Resident at the Canadian High Commission in London.

[2] Responsible for policy matters.

[3] Responsible for business development and investor liaison.

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (such as *Financing With the EBRD*), special reports (such as the *Annual Report* and *Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's website at www.ebrd.com.

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom
(Fax: +44 20 7338 7544)

Annex 1

The Bank's Financial Activities

The Bank's financial activities are divided into ordinary and special operations, depending on the source of funds. Ordinary operations are financed from the ordinary capital resources of the Bank, which comprise subscribed capital, market borrowings, and income from loans and investments. Special operations are those financed by "special funds" for specially designated purposes that are typically outside the Bank's regular activities, and are financed by donors. Unlike other regional development banks, the EBRD does not operate a concessional or "soft" loan window.

Ordinary Capital Resources

At the end of 2005, the total authorized capital of the Bank was €20 billion. Canada has subscribed to 3.4 per cent—or €680 million (C$956 million)—of the Bank's authorized capital. Canadian contributions to the Bank's capital are made in US dollars (at a pre-determined euro/US$ exchange rate).

In 2005, Canada made its eighth purchase of shares under the first capital increase (which came into effect on April 3, 1997, and doubled the initial €10-billion capital base). Under the first capital increase, 77.5 per cent of Canada's share is "callable," meaning that the Bank can request these resources in the unlikely event that it requires them to meet its financial obligations to bondholders; the balance, or 22.5 per cent, is "paid-in." Payments are being made in eight equal annual installments (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). The following table details Canadian payments to the Bank in US dollars.

Canada's contributions to the Bank's capital are non-budgetary expenditures because our shares in the Bank represent an asset. Nonetheless, Canada's paid-in contributions to the Bank do increase the Government's financing requirements.

Canadian Payments to the EBRD

Year	Notes	Cash	Encashment of notes	Total cash outlay
		(in US dollars)		
1991	11,903,502	11,903,502	11,903,502	23,807,004
1992	11,903,502	11,903,502	3,967,834	15,871,336
1993	11,903,502	11,903,502	7,935,668	19,839,170
1994	11,903,502	11,903,502	11,903,502	23,807,004
1995	11,903,502	11,903,502	11,903,502	23,807,004
1996	–	–	7,935,668	7,935,668
1997	–	–	3,967,334	3,967,334
1998	7,287,199	4,858,132	1,457,439	6,315,572
1999	7,287,199	4,858,132	2,914,878	7,773,010
2000	7,287,199	4,858,132	4,372,317	9,230,449
2001	7,287,199	4,858,132	5,829,759	10,687,891
2002	7,287,199	4,858,132	7,287,198	12,145,331
2003	7,287,199	4,858,132	7,287,199	12,145,331
2004	7,287,199	4,858,132	7,287,199	12,145,331
2005	7,287,199	4,858,132	7,287,199	12,145,331
Total	117,815,102	98,382,566	103,240,702	201,623,268

Market Borrowings

At the end of 2005, total EBRD borrowings stood at €12.5 billion with an average remaining life of 7.8 years at an average cost of funds of LIBOR (London Inter-Bank Offered Rate) minus 34 basis points. Funds have been swapped into floating-rate instruments, primarily in US dollars and euros.

Standard & Poor's has assigned the Bank an AAA long-term and A1+ short-term credit rating. Moody's Investors Service has similarly rated the EBRD long-term bonds AAA.

Special Funds

The EBRD administers a number of bilateral and multilateral technical assistance funds. Canada has contributed to the following special funds:

Canadian Technical Cooperation Fund—The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects across a wide range of sectors and EBRD countries of operations. Canada has contributed $12.65 million since the fund was established in 1992 and is currently completing Canada Phase V.

Chernobyl Shelter Fund—The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this 10-year project is roughly US$1.1 billion, of which US$716 million has been pledged so far. Canada has pledged US$33 million, including US$0.8 million of bilateral assistance for ventilation stack repair.

Nuclear Safety Account (NSA)—This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operations until the plants can be closed. The NSA complements other bilateral and multilateral nuclear safety technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed $19.5 million to the total fund of €280 million. Canada's contribution has been completely disbursed.

CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE)—By 2002, Canada had contributed $10 million in support of the EBRD's South Eastern Europe Action Plan, to be used for technical cooperation and co-financing activities. These funds, tied to Canadian consultants, were used in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, and Serbia and Montenegro. In 2003, an additional $6 million was added to the CFSEE, which focuses on CIDA priority sectors and countries of focus.

CIDA-EBRD Balkan Region Special Fund—In addition to the CFSEE, Canada has contributed $2 million to the Balkan Region Special Fund to support post-conflict reconstruction efforts in the Balkan region.

TurnAround Management (TAM) Programme—The TAM Programme was established in 1993 to match senior industrial advisors from market-driven economies with chief executives of selected firms in the region. The objective is to provide industrial management know-how and develop business skills so that these companies can become competitive and profitable. In 2003, Canada signed a new agreement with the TAM Programme to provide $2.5 million over five years to be used to hire Canadians to work as advisors. This brought Canada's total contribution to the Programme to $3.05 million.

Technical Assistance in Support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II—Between 1999 and 2004, Canada provided $3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. The technical assistance has included risk- and loan-evaluation training.

Northern Dimension Environmental Partnership (NDEP)—The NDEP provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on the environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol. Canada became an official contributor to the NDEP Support Fund at the end of 2003 and has contributed €20 million.

This made Canada the NDEP's sole non-European contributor. Canada earmarked its contribution for the facility's "nuclear window," which counts towards Canada's commitment to the G8 Global Partnership Program. To deal with nuclear waste, the NDEP provides full funding within an international cooperation framework designed to address the complex challenges of cleaning up the legacy of the former Soviet navy's Northern Fleet. In this regard, the NDEP Assembly completed a prioritization plan in 2004 that has been adopted by all contributors as the basis for projects in the nuclear window.

CIDA-EBRD Cooperation Fund for Central Asia and the South Caucasus— This $2-million fund was created in 2004 for work on project preparation and implementation activities in Central Asia and the South Caucasus. The fund targets agribusiness, natural resources and infrastructure financing (e.g. transport, telecommunications, municipal finance), and aims to strengthen institutional capacity development of local institutions working in private sector development and micro-lending institutions. Given CIDA's program focus, priority will be given to projects in Georgia and Tajikistan. This is the first Canadian bilateral fund at the EBRD that is untied (i.e. procurements are not limited to Canadians).

Early Transition Countries Multi-Donor Fund—This fund was launched in 2004. CIDA is one of 11 donors to the fund, which targets Bank programming to the seven poorest countries of the Commonwealth of Independent States region (Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan). This fund is the first EBRD funding mechanism to be classified as Official Development Assistance by the Development Assistance Committee of the Organisation for Economic Co-operation and Development. Canada has contributed €500,000 to this untied fund.

Annex 2

Doing Business With the EBRD

For general information, please refer to www.infoexport.gc.ca/ifinet or contact the Bank's Communications Department in London (tel: +44 20 7338 6096; fax: +44 20 7448 6690).

Further inquiries should be directed to the Office of the Director for Canada, Advisor for Business Development and Investor Relations, Ms. Sandy Ferguson (tel: +44 20 7338 6509; e-mail: fergusos@ebrd.com).

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with the EBRD are requested to direct initial inquiries either to the Office of the Director for Canada, to the Project Inquiries in London (tel: +44 20 7338 6282 or +44 20 7338 6252; fax: +44 20 7338 6102) or to the Bank's Resident Office in the country of operations. Summaries of EBRD private sector operations can be obtained on the Bank's website at www.ebrd.com.

Canadian Suppliers of Goods and Works: The EBRD makes available information on all stages of public sector project development, from the point a project has been identified by the Bank through to its approval. Procurement opportunities and co-financing notices, as well as contract awards information, can be accessed on the Bank's website free of charge (see address above).

Canadian Consultants: The EBRD's website contains technical cooperation notifications and invitations for expressions of interest for consultancy services pertaining to both public and private sector projects. In 2005, the EBRD launched a web-based system in order to make the consultant selection process simpler and more efficient. Known as eSelection, the system enables subscribing consultants to be notified of consulting opportunities, express interest online, submit technical and financial proposals and monitor the selection process. eSelection is designed to be user-friendly while ensuring full compliance with Bank policies and procedures.

Consultants and suppliers can sign up for electronic notification of all EBRD procurement opportunities through EBRD Procurement Alert. Current procurement information can be found at www.ebrd.com/oppor/procure/index.htm.

Individual Canadians: The EBRD maintains a recruitment section on its website, which provides information on specific employment competitions at the Bank as they become available. In general, applications for employment for permanent positions and summer jobs should be sent to:

Paolo Gallo, Director for Human Resources
Human Resources Management Department
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

Annex 3
EBRD Membership as at December 31, 2005

	Share of the Bank's capital (%)
European Members	
Austria	2.28
Belgium	2.28
Cyprus	0.10
Denmark	1.20
Finland	1.25
France	8.52
Germany	8.52
Greece	0.65
Iceland	0.10
Ireland	0.30
Israel	0.65
Italy	8.52
Liechtenstein	0.02
Luxembourg	0.20
Malta	0.01
Netherlands	2.48
Norway	1.25
Portugal	0.42
Spain	3.40
Sweden	2.28
Switzerland	2.28
Turkey	1.15
United Kingdom	8.52
European Union	3.00
European Investment Bank	3.00
Non-European Members	
Australia	0.50
Canada	**3.40**
Egypt	0.10
Japan	8.52
Korea, Republic of	1.00
Mexico	0.15
Mongolia	0.01
Morocco	0.05
New Zealand	0.05
United States	10.00

	Share of the Bank's capital (%)
Countries of Operations	
Albania	0.10
Armenia	0.05
Azerbaijan	0.10
Belarus	0.20
Bosnia and Herzegovina	0.17
Bulgaria	0.79
Croatia	0.36
Czech Republic	0.85
Estonia	0.10
FYR Macedonia	0.07
Georgia	0.10
Hungary	0.79
Kazakhstan	0.23
Kyrgyz Republic	0.10
Latvia	0.10
Lithuania	0.10
Moldova	0.10
Poland	1.28
Romania	0.48
Russia	4.00
Serbia and Montenegro	0.47
Slovak Republic	0.43
Slovenia	0.21
Tajikistan	0.10
Turkmenistan	0.01
Ukraine	0.80
Uzbekistan	0.21

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Government
Publications

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

2006



CANADA'S NEW GOVERNMENT

Canada

Government
Publications

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

2006

Department of Finance Canada
Ministère des Finances Canada

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A Word From the Minister of Finance

I am pleased to present to Members of Parliament and to the Canadian public the Department of Finance's 2006 *Report on Operations Under the European Bank for Reconstruction and Development Agreement Act*. This report responds to the requirement laid out in Article 7 of the European Bank for Reconstruction and Development Agreement Act that the Minister of Finance "shall cause to be laid before each House of Parliament by March 31 of each year or, if that House is not then sitting, on any of the thirty days next thereafter that it is sitting," a report containing a general summary of operations under this act, including their sustainable development and human rights aspects.

The format of this report differs significantly from those of past years. Given feedback from parliamentarians and civil society on this report and its companion report (*Report on Operations Under the Bretton Woods and Related Agreements Act*), this report has been recast with three goals in mind:

1. To improve the accountability of the Department of Finance in managing Canada's relationship with the European Bank for Reconstruction and Development (EBRD).
2. To make Canada's policy objectives with respect to this institution clearer, which in turn will make it easier to measure success.
3. To have Canada continue to push the frontiers of disclosure, without violating Canada's requirement to respect the confidentiality policies of the EBRD.

The 2006 report focuses more clearly on Canada's policy objectives at the EBRD, which can be summarized as:

1. Promoting good governance and accountability, including respect for human rights.
2. Promoting the environmental sustainability of EBRD projects.
3. Ensuring that the EBRD shifts its operations to where transition is less advanced.
4. Advancing Canadian commercial interests.

It is my hope that this report will provide parliamentarians and all Canadians with a better understanding of the role that Canada is playing in promoting governance and accountability in the institution and in ensuring that the EBRD's operations accord with its transition mandate.

The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance

Mandate and Role of the EBRD

Overview

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aims are to foster the transition towards open, market-oriented economies in Central and Southeastern Europe, as well as in the successor states of the former Soviet Union,[1] and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multi-party democracy, pluralism and market economics.[2] To deliver on its mandate, the Bank focuses its activities on assisting its 29 countries of operations in implementing economic reforms, taking into account the particular needs of countries at different stages in the transition process. The EBRD also places particular emphasis on the promotion of democratic institutions and human rights in its countries of operations.

The Bank's overriding focus is the private sector, with a strong operational emphasis on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD's charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. All of its financing projects have to demonstrate environmental sustainability as per the Bank's Articles of Agreement. In promoting economic transition, the Bank acts as a catalyst for increased flows of financing to the private sector, as the capital requirements of these countries cannot be fully met by official multilateral or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the central Asian republics. For example, in 2006, for every euro the EBRD invested, it mobilized an additional 1.7 euros from the private sector and other multilateral and bilateral agencies.

The EBRD's operations to advance the transition to a market economy are guided by four principles: transition impact, additionality, sound banking and environmental sustainability. Financing is provided for projects that expand and improve markets, help to build the institutions necessary for underpinning a market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also mobilize additional sources of financing and not displace them. Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers attractive returns. Adherence to sound banking principles also helps to ensure the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector. Finally, the Bank assesses the environmental sustainability of all of its projects, and its project environmental safeguards are leading-edge.

The Bank's medium-term operational priorities are premised on: the central importance of creating and strengthening institutions that ensure markets work well; the key role that small businesses can play in creating dynamic, competitive and more equitable economies; and the relevance to the transition process of the Bank's mandate to support countries committed to and applying the principles of multi-party democracy and pluralism.

[1] In 2006, all members formally accepted Mongolia as one of the Bank's countries of operations.

[2] Article 1, Agreement establishing the European Bank for Reconstruction and Development.

To achieve these priorities the Bank focuses on:

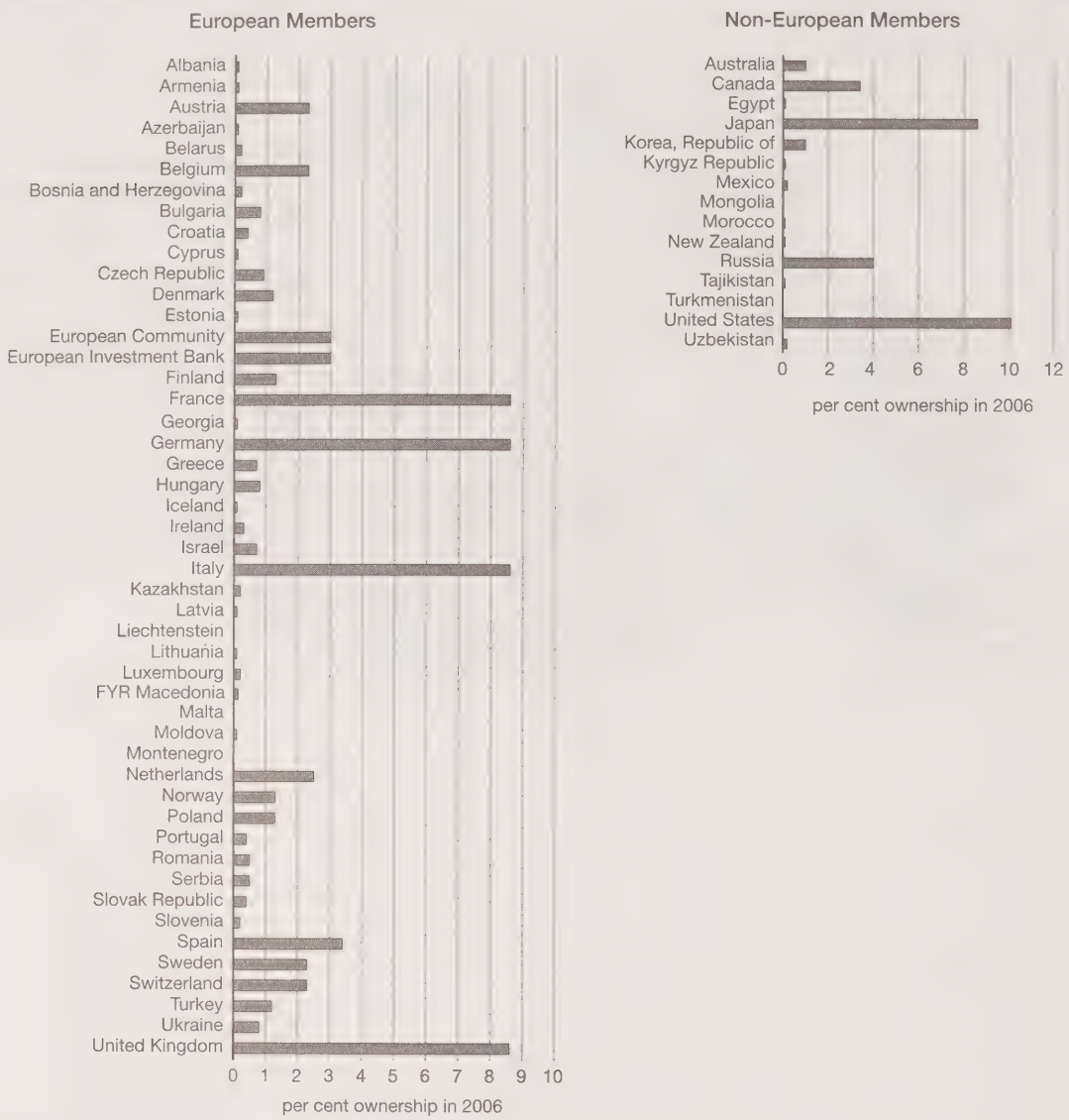
- Promoting transparency and accountability in public sector management.
- Developing sound financial sectors linked to the needs of enterprises and households.
- Providing leadership for the development of micro-lending and small and medium-sized enterprises (SMEs).
- Developing market-based and commercially oriented infrastructure.
- Demonstrating, through selected examples, effective approaches to restructuring viable large enterprises.
- Taking an active approach in its equity investments to improve corporate governance.
- Engaging governments in policy dialogue to strengthen institutions and improve the investment climate.
- Taking a regional approach where appropriate.
- Promoting sustainable development and environmental due diligence.

Countries of Operations

The EBRD has 63 members: 61 countries, the European Community and the European Investment Bank.



Chart 1
EBRD Membership



Note: Canada's 3.4-per-cent share in the EBRD translates to an equivalent percentage of votes in the organization.

How the EBRD Works

The highest authority in the Bank is the Board of Governors. It meets annually and approves the institution's annual report, budget, financial statements and independent auditor's report, the election of the Chair and Vice Chair for the next Annual Meeting, as well as other items requiring Governors' approval. A Governor and an Alternate Governor represent each member country. The Board of Directors, which is responsible for the general operations of the Bank, is composed of 23 members, of which four are non-Europeans.

The EBRD's share capital is provided by member countries, with proportional voting rights. The EBRD's authorized capital is €20 billion—Canada's capital share is 3.4 per cent.

Project Finance

The EBRD offers a full array of financial products and services, including:

- Longer-term loans.
- Equity investments.
- Quasi-equity instruments (subordinated loans, preferred stock, income notes).
- Guarantees and standby financing.
- Risk management (intermediation of currency and interest rate swaps, provision of hedging facilities).

Eligibility

Eligible projects must be supported by a strong business case, benefit the economy of the host country and comply with the EBRD's environmental guidelines. Projects in all industries are eligible for EBRD financing except those producing military equipment, tobacco and distilled alcohol. Although it primarily finances private sector projects, the Bank may provide financing to state-owned companies provided they are operating competitively, particularly if the financing attracts private and/or foreign capital. The EBRD may finance both locally and foreign-owned private companies, as well as joint ventures between foreign and local shareholders.

In order to ensure the participation of private sector investors and lenders, the EBRD limits the total amount of debt and equity financing for any single project to 25 per cent of total estimated project costs. However, in certain circumstances, it may provide up to 35 per cent of the equity capital for a project, provided it is never the largest shareholder.

EBRD investments range from €5 million to €230 million. Smaller projects are financed both directly by the EBRD and through local financial intermediaries. By supporting local commercial banks, micro-finance banks, equity funds and leasing facilities, the EBRD has helped finance over 1 million smaller projects.

Fees

The EBRD charges market rates for its private sector financing and provides uniform loan pricing for sovereigns of LIBOR (London Inter-Bank Offered Rate) +100 basis points. In addition, fees vary according to the nature of the project and the amount and complexity of the work required of the EBRD.

Funding of EBRD Activities

The EBRD's equity and quasi-equity investments are funded out of its net worth—the total of paid-in capital and retained earnings. Of the funding required for its lending operations, 100 per cent is borrowed in international financial markets through public bond issues or private placements. The EBRD's bond issues have been given triple-A ratings by Moody's Investors Service and Standard & Poor's.

Advice and Technical Assistance

The Bank uses its close relationship with governments in the region of operations to promote policies that bolster the business environment. The EBRD advises governments on how to promote a sound investment climate and a stronger institutional framework, which helps to ensure a well-functioning private sector. The EBRD provides advisory services in the following areas: effective legal and regulatory framework, business integrity and sound corporate governance, anti-corruption practices, fair and predictable taxation, and transparent accounting.

Canada's Representation at the EBRD: The Honourable James M. Flaherty, Minister of Finance, is the Canadian Governor and Mr. Peter Harder, Deputy Minister of Foreign Affairs, is the Alternate Governor. Canada's representative on the EBRD Board of Directors is André Juneau. The Minister (Economic/Commercial) at the Canadian High Commission in London, Ms. Judith St. George, is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

Canada's EBRD Priorities

Canadian Policy Priorities

Canada's participation in the EBRD supports our international development and foreign policy priorities. Canada is committed to sustainable development that promotes democracy, peace and security, human rights and equality and contributes to a more secure, equitable and prosperous world. By fostering transition towards open, market-oriented economies in its countries of operations, the Bank advances Canada's international priorities, strategic interests and values. Through sound investments that support economic growth and contribute to the transition region's integration into the world economy, the EBRD promotes prosperity and stability, which are important to Canada as a trading nation.

The Government of Canada has four priorities in relations with the EBRD:

1. Promoting good governance and accountability (at the national and corporate level), including respect for human rights.
2. Promoting the environmental sustainability of EBRD projects.
3. Ensuring that the EBRD maintains a strong transition focus and shifts its operations to countries where transition is less advanced.
4. Advancing Canadian commercial interests.

1. Governance and Accountability

Canada's involvement with the EBRD provides the opportunity to promote the Canadian values of democracy, rule of law, accountability and respect for human rights. Canada is a strong proponent of the Bank's ongoing efforts to improve and strengthen governance and accountability in its countries of operations (through technical assistance programs and dialogue with national and local authorities) so as to ensure increased transparency, optimal use of investment funds, promotion of the rule of law, respect for human rights, safety and equality. Canada also supports the Bank's efforts to encourage mechanisms of multilateral cooperation on democratic issues.

Improved Corporate Governance

Canada has maintained that the Bank's fundamental priority for private sector development is to create an enabling environment for investment and sound regulatory frameworks for the private sector to develop in a sustainable fashion. Good governance helps ensure that corporations integrate into the international financial system and strengthens their international competitiveness. Strong, transparent governing institutions improve their effectiveness and accountability towards their people. To this end, through technical cooperation funds, the EBRD advises national and local governments on ways to improve and strengthen their institutional frameworks in order to ensure a well-functioning private sector.

Strong Internal Governance

Canada is pleased with the Bank's commitment to enhance the transparency of its activities, in line with modern corporate governance practices. This focus is consistent with efforts at other international financial institutions (IFIs), which Canada has also strongly supported.

Canada welcomes the Bank's efforts to benchmark its practices against those of other IFIs. The EBRD has developed and implemented a series of policies and strategies—most notably Codes of Conduct and an Anti-Corruption Strategy—to ensure that it follows best practices. These are described in detail in the section "Canada's Focus in 2006."

Strong Democratic Institutions

In keeping with its mandate to promote economic and democratic reform, the Bank regularly reviews political and economic progress in transition in its countries of operations. The EBRD has limited its operations in Belarus, Turkmenistan and Uzbekistan, where the commitment to core democratic principles is particularly weak. The country strategies for Belarus and Turkmenistan were renewed in 2006 and, given the lack of progress in economic and political reform in both countries, the Bank's approach of severely restricting its operations was reconfirmed. As the geographical focus of the Bank's operations continues to shift to more challenging environments, the EBRD's commitment to the political requirements of Article 1 remains imperative. EBRD analysis shows a strong, positive relationship between progress in transition and political liberalism, i.e. the establishment of strong, democratic institutions.

2. Environmental Sustainability

Environmental and social issues are increasingly regarded as fundamentally connected with long-term sustainability of economic performance, political stability and the quality of life of a region's inhabitants. Canada has an interest in promoting environmental sustainability in the transition region as a means of fostering a strong global economy. Canada is therefore a strong proponent of sustainable best practices with respect to EBRD investments in both the public and private sector. EBRD priorities include:

- Fully integrating environmental and social (e.g. health and safety, labour and community issues) considerations into the project cycle and ensuring that each project considered for financing undergoes environmental and social appraisal.
- Promoting environmental investments across a variety of sectors to achieve resource efficiency, cleaner production processes, biodiversity and best practice in environmental management.
- Financing projects with clear environmental objectives, such as better water and wastewater management, energy efficiency and renewable energy, and working in partnership with other institutions to address regional and global environmental issues.[3]

3. Transition Impact

Canada has a strong interest in ensuring that nascent democratic regimes have access to the financing and advice they need in order to deliver on their political and economic efforts towards transition to market-oriented democracies. The EBRD has an important role to play in this process. The entry of eight EBRD borrowers into the European Union in May 2004 marked a milestone in the transition process and its success. The EBRD played no small part in this process, helping these countries create the right conditions to attract private sector financing without the Bank's participation. Going forward, the Bank must shift its operations to borrowing countries in the former Soviet Union and Southeastern Europe that have the greatest need for the EBRD's support.

[3] *EBRD Sustainability Report 2005: Working Towards a Sustainable Future.*

4. Advancing Canadian Commercial Interests

The EBRD offers a number of investment opportunities for Canadian businesses, including financial institutions. The objectives of the Canadian office are to increase Canadian awareness of these investment opportunities, explain how the Bank's financing mechanisms work, and ensure that EBRD policies and procedures are followed in a transparent and fair manner.

To achieve these objectives, the Canadian office provides EBRD market information and intelligence to Canadian firms and advises Canadian project sponsors on EBRD financing options. In addition, the office develops commercial co-financing opportunities with Export Development Canada and other Canadian financial institutions. Together with the Department of Foreign Affairs and International Trade and Industry Canada, the office also identifies EBRD procurement opportunities and, with the Canadian International Development Agency (CIDA), promotes Canadian technical cooperation activities and official co-financing with the EBRD.

In 2006, the Board of Directors approved two investments with Canadian involvement. The first involved a loan to support the modernization and expansion of Chelopech Mining EAD, a Bulgarian company which is fully owned by Dundee Precious Metals Inc. of Toronto. The second was a multi-vendor leasing framework in Russia, which was jointly developed by Export Development Canada and the EBRD.

In 2006, 14 contracts totalling €4.6 million were awarded to Canadian consultants for project preparation, project implementation and investment climate reform support. The assignments were funded by CIDA technical cooperation funds at the EBRD (eight assignments), by the EBRD directly (four assignments), and through other untied technical cooperation funds at the EBRD (two assignments).

Canada's Voting Record in 2006

On January 30, 2004, the Minister of Finance, as Governor for Canada at the EBRD, voted to amend the Agreement establishing the European Bank for Reconstruction and Development to authorize the Bank to undertake operations in Mongolia. This proposal had the unanimous support of EBRD members, given Mongolia's close economic linkages to the former Soviet bloc countries and its long history with central planning. Canada ratified the amendment to the EBRD's Articles of Agreement in the Budget Implementation Act, 2006.

On June 3, 2006, after declaring its independence from the State Union of Serbia and Montenegro and being recognized as an independent country by the international community and the Government of Serbia, the Republic of Montenegro was formally admitted as a member of the EBRD. In September 2006, following a Governors' vote, which Canada supported, the Republic of Montenegro became a borrowing member of the EBRD.

On November 6, 2006, Governors voted to adjust the formula for calculating the remuneration of Directors, Alternate Directors and the President of the EBRD. Canada supported proposed changes.

Canada's Voting Record

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board of Directors. As a result, decisions at the Board are generally taken by consensus. Directors may, however, abstain or vote against projects or policies in consultation with their constituencies. Canada supported all policies in 2006 as well as the vast majority of the 300 projects approved. There were 13 exceptions for three main reasons.

- **Lack of additionality.** Additionality is one of the EBRD's core operating principles—project investments should support private investors without crowding them out. If it is possible that an investor could have access to private sector funding on reasonable terms, additionality concerns are raised. Canada abstained from voting on or voted against three projects on these grounds.
  1. An EBRD investment in the Royalton Partners II regional equity fund. This fund will make controlled or equity-related investments in middle-market private and privatized companies in Central Europe. The fund will focus on non-tradable sectors and will seek opportunities to increase value by improving operations and/or expanding businesses. Canada voted against the project.
  2. An EBRD loan to a Russian bank (MDM Bank) to support its lending operations. Canada abstained from voting on the project due to additionality concerns.
  3. An EBRD loan to a Russian subsidiary of LG to help finance a new consumer electronics and white goods production facility near Moscow. Canada abstained from voting on the project due to additionality concerns, also referencing its marginal transition impact.
- **Lack of transition impact.** Helping to move a country closer to a full market economy (the "transition impact") is another of the EBRD's core operating principles. As per Article 2 of the Agreement establishing the European Bank for Reconstruction and Development, transition is fostered through various measures including: promoting the establishment, improvement and expansion of productive, competitive and private sector activity and the mobilization of capital and experienced management to this end; fostering productive investment, including in the service and financial sectors, and in related infrastructure where necessary to support private and entrepreneurial initiative; providing technical assistance; and supporting multinational projects and/or projects with more than one donor country. Where it is anticipated that an investment will not achieve an incremental transition impact on these terms, concerns are raised. Canada abstained from voting on or voted against five projects on these grounds.
  4. A seventh extension of the EU/EBRD SME Finance Facility to partner banks for on-lending to micro and small enterprises (MSEs) in the EU accession countries (Bulgaria, Romania and Croatia). While it supports the Facility's objectives, Canada abstained from voting on the extension due to the use of EU-funded interest rate subsidies.
  5. A loan to VTB Retail Financial Services for on-lending to MSEs in Russia. Canada voted against the project, also referencing questionable use of a state-owned bank as a financial intermediary.
  6. An equity investment in the Russian bank Ogresbank. Following the entrance of a strong, strategic investor, the project's transitional impact became less clear. Canada abstained from voting on the investment, also referencing additionality concerns.
  7. A loan to Sukhoi Civil Aircraft Company to help finance the development and manufacturing of a regional jet in Russia. Canada voted against the project, also referencing concerns about significant state aid and additionality.
  8. A loan to help finance the design, construction and start-up costs of a super-regional mall (Kashirka Mall) in southeast Moscow. Canada abstained from voting on the project.

Canada's Voting Record *(cont'd)*

- **Discord with Canada's policy on steel**. Canada does not support steel projects at multilateral development banks that contribute to excess global capacity given that there is already global oversupply. Canada abstained from voting on or voted against five projects on these grounds:
  9. A loan to Mittal's Ukraine subsidiary (Mittal Steel Kriviy Rih) to optimize current capacity and improve energy efficiency. Mittal acquired the subsidiary in November 2005 in a transparent, market-priced re-privatization of the company. Despite the proposed operational and environmental improvements, Canada voted against the project, also citing additionality concerns.
  10. A loan to help restructure a steel mill in Romania (S.C. Donasid) to enable it to increase production. Canada abstained from voting on the project.
  11. A co-generation project in Ukraine (Ekoenergia) to help increase steel production. Canada abstained from voting on the project.
  12. A modernization project in Russia for the ChTPZ Group. Canada abstained from voting on the project.
  13. A loan to ISTIL Ukraine to support the company's financial restructuring and growth. Canada abstained from voting on the project.

Canada's Focus in 2006

1. Improved governance and accountability.
2. Reinforcement of Article 1 of the Agreement establishing the European Bank for Reconstruction and Development.
3. Reassessment of the EBRD's mission and a new operational framework.
4. Promotion of a sound investment climate through strong institutions.
5. Environmental sustainability.

1. Governance and Accountability

A key element underpinning the Bank's ability to influence transition is the demonstration effect of its own governance policies. The EBRD, therefore, must set for itself the very highest standard of internal governance. Canada supported the Bank's efforts to ensure that its internal policies continue to conform to best practices.

Codes of Conduct

Canada supported the introduction of new Codes of Conduct for EBRD officials and the EBRD Board of Directors. The new codes were introduced following a review in 2004 which recognized the need to update the Bank's original Code of Conduct.

The new Codes of Conduct, approved by Governors at the 2006 Annual Meeting, have been aligned with the existing best practices of other international financial institutions (IFIs). They also provide guidance on avoiding and handling conflicts of interests; establish a transparent mechanism for

examining requests for derogations; regulate the manner in which private financial affairs can be conducted and the level of disclosure required; and provide for a robust procedure for dealing with alleged breaches of the codes.

Public Information Policy

Canada was active in encouraging the Bank to enhance the transparency of its activities, in line with modern corporate governance practices. This focus is consistent with efforts at other IFIs, which Canada has also strongly supported.

Canada welcomed the Bank's decision to broaden its public disclosure policy. In 2006, the Bank agreed (a) to disclose minutes of Board of Directors' meetings; (b) to make more information on its internal organization available on its website (including the Bank's organigram, as well as the terms of reference and membership of committees of the Board of Directors); (c) to make project summary documents available in relevant national languages; (d) to provide a summary of the annual staff compensation and benefits proposal; and (e) to post a list of policies and strategies scheduled for development or review in the year ahead.

Anti-Corruption Strategy

Canada was also active in pressing the Bank to strengthen its anti-corruption policy. Canada supported the Bank's proposal to amend its practices and fight corruption in line with the harmonized approach developed by the main IFIs. Canada commended the Bank's effort to move quickly with the adaptation of the new harmonized definitions and subsequent amendments to its existing procurement policies and rules, so that they conform with the common strategic approach developed by main IFIs.

Canada is looking forward to the first report on results, in particular to seeing how well the new anti-corruption and fraud prevention guidelines have been balanced with the Bank's objective to support the development of the private sector.

Canada commended the Bank for publishing its first anti-corruption report,[4] aimed at informing shareholders, other financial institutions and investors about the EBRD's efforts to combat corruption and fraud in its own operations. The report also includes highlights of studies dealing with the prevalence of corruption in the EBRD's countries of operations.

2. Commitment to Article 1—Engagement in Belarus

Canada took a strong stand in favour of a vigorous interpretation of the Bank's responsibilities under Article 1 of the Agreement establishing the European Bank for Reconstruction and Development to severely restrict operations in countries where the commitment to democratic values is very weak. The EBRD has an explicit political mandate, as set out in Article 1, to foster transition in countries that are committed to and applying the principles of multi-party democracy and pluralism. In countries with poor democratic and human rights records such as Belarus, the Bank limits its scope of activities to the financing of the private sector while continuing to seek ways of improving the investment climate and supporting reform efforts.

[4] Available at www.ebrd.com/about/integrity/report.pdf.

The new EBRD Strategy for Belarus, approved in 2006, reflects the fact that the country's progress towards implementing Article 1 continues to be slow and characterized by setbacks. The development of the new strategy had a high profile in Canada, given the Canadian government's firm position on the need for democratic reform in Belarus. In practical terms, at IFIs, Canada has consistently opposed EBRD lending to the Belarus government, while holding open the possibility of supporting small EBRD operations with private sector entities that address basic human needs. The EBRD's new strategy for Belarus, which continues to focus exclusively on the private sector, is consistent with this approach.

3. Reassessing the Bank's Mission and Operations

Canada played an active role in the development and discussion of the EBRD's third Capital Resources Review (CRR3), stressing the need for the institution to move decisively to increase its operations in the early transition economies of the former Soviet Union and Southeastern Europe. At the EBRD's 2006 annual meeting, Governors approved the CRR3, which outlines new strategic directions that define the Bank's transition objectives, operational activities, risk management, financial performance and resource requirements. A key feature of this strategy is the graduation, by 2010, of the eight Central European countries that joined the EU in 2004. The strategy will commence with the consolidation and closure of three resident offices in Central Europe in 2007, complemented by an expanded presence in other countries, including Russia and Ukraine.

Canada welcomed the CRR3 and supported the EBRD's shift in operations to Southeastern Europe and the former Soviet Union, where more significant transition challenges remain. This strategic framework will ensure that the EBRD's resources are allocated to where they can yield the greatest transition impact.

4. Promotion of a Sound Investment Climate

A Well-Functioning Financial Sector

Canada strongly supports the EBRD's activities in the financial sector as vital to integrating transition countries into the global economy. The EBRD seeks to strengthen confidence in the financial sector primarily by helping to improve local institutions' governance and business practices. It also tries to improve financial supervision and regulation, although its activities here are constrained by its investor role in the sector and potential concerns about conflict of interest. Nonetheless, as a reputable foreign investor in the sector, the Bank offers important insights on supervisory and regulatory requirements, which it shares with other IFIs operating in the region and with governments. To address competition and independence, EBRD investments attempt to increase the diversity of institutions and services available, particularly to the private sector and micro, small and medium-sized enterprises, to facilitate foreign direct investment and to strengthen the commercial orientation of state-owned financial institutions, particularly in preparation for privatization.

The Bank also contributes to a well-functioning financial sector through its efforts to stimulate the development of local capital markets. One approach involves the EBRD working with authorities to help develop the legal framework for the issuing of local currency bonds. The EBRD's three domestic ruble floating-rate note issues (one in 2005 and two 2006) highlight both the transition potential of developing local capital markets and the extensive regulatory dialogue required.

In preparing these issues, the Bank has worked closely with the Russian authorities since 1999 and has provided technical and legal expertise to develop the framework for the issuance of long-term local currency bonds. The bonds represent an important step in the development of the Russian capital market, as they introduce a new asset class to Russia and open the door to other international issuers. The EBRD is working with other governments, including in Ukraine and Kazakhstan, with the same objective in mind.

Micro, Small and Medium-Sized Enterprises

Canada supports the Bank's strategy to promote micro, small and medium-sized enterprise (MSME) growth, develop proper financial instruments for MSME support and encourage the development of strong business associations. Canada is a strong proponent of fostering the development of local management expertise, skills and innovation. It is a strong supporter of the Bank's strategy for the MSME sector, which is founded on three pillars: financing, improving the investment climate through policy dialogue and developing business support networks for MSMEs. The strategy explicitly recognizes that the poor investment climate, and not just limited access to financing, is a major impediment to the development of the sector.

Fostering the development of strong private sectors in its countries of operations is an essential element of the EBRD's strategy for promoting the transition to a market economy. A strong MSME sector is the backbone of a country's sustained economic growth and is crucial to help countries become internationally competitive and self-sufficient. A dynamic local workforce undertaking a full spectrum of business activities, coupled with well-established local financing arrangements, ensures that countries are less vulnerable to global capital movements.

5. Environmental Sustainability

Sustainable Energy Initiative

Canada welcomes an expanded role for the EBRD on the issues of climate change and increased energy security. Canada has already contributed some funds to the Sustainable Energy Initiative through its €20-million commitment to the "nuclear window" of the Northern Dimension Environmental Partnership Support Fund.

As one of the fastest-growing parts of the world, the transition region has a growing demand for energy. One of the major challenges facing the region is inefficient use of energy, a legacy of the former command economy that undermines the competitiveness of enterprises and economies, threatens energy security and contributes disproportionately to carbon emissions.

The EBRD presented its Sustainable Energy Initiative at the 2006 Annual Meeting, and the initiative was broadly supported by the Bank's shareholders. Under the new initiative, the Bank would more than double its energy efficiency and cleaner energy investments over the next three years by mainstreaming sustainable energy investments across all sectors, strengthening the Bank's capacity to deliver; ramping up its policy dialogue in cooperation with other international institutions; and establishing a new partnership with donors to support the initiative.[5]

[5] EBRD, *Sustainable Energy Initiative: Furthering Transition, Securing the Future—Summary Document*, July 2006.

Canada's Participation in the EBRD

Benefits of Participation

Canada's membership in the EBRD and its active participation in the discussion of policy and operational issues enable it to project Canadian values and to help shape regional norms and rules. By supporting continued political and economic reform in Central and Southeastern Europe and the former Soviet Union, Canada is contributing to the region's stability and integration into the world economy.

Canada and the Bank share the overriding objective of developing a strong private sector in the Bank's countries of operations by mobilizing financing for projects with a high transition impact and by providing advice and technical assistance to businesses and governments. Through its participation in the EBRD's Board of Directors' policy discussions, Canada has been able to reinforce this mandate and press for greater attention to governance issues in the Bank's operations. Moreover, Canada has been able to help shape environmental and social safeguard policies that govern EBRD lending. The EBRD also provides Canada with a vehicle through which it can reach poor transition countries that are not normally reached through our bilateral development assistance programs.

As detailed earlier, Canada is also interested in securing important commercial benefits. In order to implement transition projects, the Bank often relies on goods and services from its members through procurements. This allows Canadian firms to have access to different markets and to enjoy commercial opportunities they may not otherwise have. An area where Canada has a comparative advantage and where Canadians have been successful in winning EBRD-financed contracts is consulting services. In 2006, however, interest by Canadian companies in bidding on EBRD-financed public tenders was weak, and no Canadian firm was awarded a tender. However, the EBRD offers Canadian companies considerable opportunities to finance investments in its countries of operations as well as access to public sector tenders.

Looking forward, the EBRD hopes to increase the number of high-quality Canadian project sponsors with which it invests to better align its official co-financing and technical cooperation needs with Canadian interests in the region, and to strengthen its partnership with Export Development Canada and other Canadian commercial co-financiers.

Governmental and Professional Involvement

Role of Canadian Government Departments—Within the Canadian government, responsibility for oversight of the EBRD's activities resides with the International Policy and Institutions Division of the Department of Finance. In consultation with the Department of Foreign Affairs and International Trade and the Canadian International Development Agency (CIDA), the Department of Finance regularly reviews the Bank's policy papers and proposed country strategies and provides advice to the Canadian Director.

Functions of the Canadian Director—In addition to participating in regular Board meetings, the Canadian Director is currently a member of the Board of Directors' Budget and Administrative Affairs Committee, which monitors efficiency, cost control and budgetary prudence, oversees the Bank's human resources policies (including those relating to governance and ethics), and ensures that the Bank's resources are directed towards its priorities.

Canadian Staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2006, there were 23 Canadian professionals on the staff of the EBRD, representing 3.4 per cent of total professional positions, equal to Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that Canadians fill the following positions: Director of Communications, Director of the Procurement Department and Director of the Early Transition Countries Initiative. Members of the Canadian Director's office made a number of visits to Canada and the EBRD's countries of operations in 2006 to meet with business people, conduct seminars, speak at conferences and consult with government officials.

The following events in 2006 were supported by the Canadian Director's office and promoted Canada's interests:

- The Canadian Director and Business Advisor participated in the Canada Trade Days in Kiev, Ukraine, which was sponsored by the Canadian Embassy in Kiev.
- The Canadian Director went to Moscow to participate in the Adam Smith Conference and meet with Canadian and Russian business and government officials.
- On the Canadian outreach side, the Canadian Director and the Business Advisor organized the visit of EBRD President Jean Lemierre to the Conférence de Montréal and arranged a business program, including additional meetings with Canadian corporates interested in investing in the Bank's region of operations
- The Business Advisor and an EBRD Russia team senior banker participated in the Canada Eurasia Russia Business Association (CERBA) Canada-Russia forestry business seminar. The Advisor also participated in the Globe Environmental Industries Effective Bidding Workshop in Vancouver to identify opportunities for Canadian companies in environment-related procurement at the EBRD, as well as the annual CIDA/CME (Canadian Manufacturers & Exporters) International Development Days (IDD) held in Winnipeg. The Canadian office arranged for the EBRD Director of the Consulting Services Unit to participate in the CIDA/CME IDD, as well as business outreach programs with the Ontario and Alberta governments and industry association representatives in Toronto and Calgary.
- The EBRD's Deputy Chief Economist and Director, Strategy and Analysis and the Canadian Policy Advisor travelled to Toronto and Ottawa to present to business, academics and government officials key findings of the Bank's 2006 *Transition Report* on developments in the business and economic environments of the Bank's countries of operations.

Contribution to Ordinary Capital Resources

At the end of 2006, the total authorized capital of the Bank was €20 billion. Canada's share is 3.4 per cent, or €680 million (C$968 million), of which 25.3 per cent, or C$245.2 million, is paid-in. The remainder is callable and would be provided only in the unlikely event that the EBRD faces severe financial difficulty. Canada's paid-in contribution is treated as a non-budgetary expenditure as shares in the Bank are considered an asset. Our callable capital represents a contingent liability.

Canada's paid-in capital is being provided in a series of instalments of cash and non-interest-bearing demand notes, which are then encashed over a five-year period. Payments are made in eight equal annual instalments (40 per cent in cash and 60 per cent in non-interest-bearing demand notes). Canada's last note encashment will be made in 2009.

Canadian Payments to the EBRD

Year	Total cash payments in US$ (includes note encashment and cash payments)	Total cash payments in C$[1] (includes note encashment and cash payments)
1991	23,807,004	27,278,065
1992	15,871,336	19,177,335
1993	19,839,170	25,588,561
1994	23,807,004	32,517,987
1995	23,807,004	32,677,494
1996	7,935,668	10,821,077
1997	3,967,334	5,492,325
1998	6,315,572	9,366,645
1999	7,773,010	11,549,451
2000	9,230,449	13,709,085
2001	10,687,891	16,549,305
2002	12,145,331	19,072,539
2003	12,145,331	17,021,217
2004	12,145,331	15,807,394
2005	12,145,331	14,715,677
2006	5,829,759	6,611,492
2007	4,372,320	4,958,620[2]
2008	2,914,880	3,305,747[2]
2009	1,457,440	1,652,873[2]

Notes: [1] Exchange rates are based on Bank of Canada annual noon exchange rate averages.

[2] 2006 exchange rate used as an estimate.

EBRD Transactions in Canada or in Canadian Currency

The EBRD did not undertake any transactions in Canada in 2006.

Contribution to Special Funds

In addition to its financing activities through loans and equity investments, the EBRD advises businesses on a variety of issues, including: physical and financial restructuring; the formulation of business plans; identification of markets, products, technologies, and financial and technical partners; and mobilization of project finance. These advisory services are provided through special funds set up in partnership with donor countries and/or donor institutions. As the Bank continues to shift its operations towards the south and the east of the transition region, these funds and the technical capacity-building assistance they offer will grow in importance. Canada has contributed to the following special funds:

Early Transition Countries Multi-Donor Fund—CIDA is one of the 11 donors to this multi-donor fund, which was launched in 2004 and targets Bank programming in the seven poorest countries of the EBRD's region of operations (Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan). This fund is the first EBRD funding mechanism to be classified as Official Development Assistance by the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD/DAC). Canada has contributed C$1.7 million to this untied fund.

Canadian Technical Cooperation Fund—The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects across a wide range of sectors and EBRD countries of operations. Canada has transferred C$17 million to the EBRD for technical cooperation since 1992. Canada's contribution, which was renewed in 2006 for an additional three years until 2009, includes technical cooperation in Armenia, Georgia, Russia and Ukraine, and focuses on the environment, private sector development and municipal governance.

Chernobyl Shelter Fund—The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this 10-year project is roughly US$1.1 billion, of which US$716 million has been pledged so far. Canada has pledged US$33 million, including US$0.8 million of bilateral assistance for ventilation stack repair.

Nuclear Safety Account (NSA)—This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operations until the plants can be closed. The NSA complements other bilateral and multilateral nuclear safety technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of €280 million. Canada's contribution has been completely disbursed.

CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE)—By 2002, Canada had contributed $10 million in support of the EBRD's South Eastern Europe Action Plan, to be used for technical cooperation and co-financing activities. These funds, tied to Canadian consultants, were used in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, Serbia and Montenegro. In 2003, an additional $6 million was added to the CFSEE to support work on CIDA priority sectors and countries of focus. CIDA is participating, through the CFSEE, in a newly created Western Balkans Initiative, which includes within its scope a multi-donor technical cooperation fund and is intended to improve donor coordination arrangements in the Western Balkans.

TurnAround Management Programme—The TurnAround Management Programme was established in 1993 to match senior industrial advisors from market-driven economies with chief executives of selected firms in the region that are in financial difficulty. The objective is to provide industrial management know-how and develop business skills so that these companies can become competitive and profitable. Canada has contributed C$2.55 million to this fund.

Technical Assistance in Support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II—Canada agreed to provide C$3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. To date, C$2.12 million has been transferred to the Bank for technical assistance that includes risk- and loan-evaluation training. The Fund is now being used in support of the Mortgage Lending Framework, focusing on local banks' capacity building.

Northern Dimension Environmental Partnership—Canada is the sole non-European contributor to this fund, which provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Canada has committed €20 million, which is earmarked for the facility's "nuclear window" and counts towards Canada's commitment to the G8 Global Partnership Program.

CIDA-EBRD Cooperation Fund for Central Asia and the South Caucasus—This C$2-million fund was created in 2004 for work on project preparation and implementation activities in Central Asia and the South Caucasus. The fund targets the following sectors: agribusiness, natural resources, infrastructure financing (e.g. transport, telecommunications, municipal finance), and capacity development of local institutions working in private sector development and micro-lending institutions. Given CIDA's program focus, priority will be given to projects in Georgia and Tajikistan. This is the first Canadian bilateral fund at the EBRD that is untied (i.e. procurements are not limited to Canadians).

Summary of EBRD Operations in 2006

2006 was an eventful year at the EBRD. Following the Annual Meeting, the Bank embarked on implementing the third Capital Resources Review (CRR3), a forward-looking, medium-term strategy that reflects a new focus in its operations. This new plan requires the Bank to revisit some of its existing policies and develop new ones to respond to challenges anticipated over the next five years.

The operational objectives of the CRR3 are to develop the portfolio with a base-case objective of €21.9 billion by 2010, and to achieve an annual business volume of around €3.6 billion. The geographical composition of the annual business volume is projected to shift in line with the strategic direction of the CRR3. The portfolio share of the early and intermediate transition countries and Russia is set to grow to around 87 per cent by 2010.

The CRR3 resource framework reflects both the increased workload driven by a rising portfolio in a more complex environment and a sustained focus on efficiency and internal resource reallocation. To support the CRR3 resource framework requirements, the EBRD administrative budget for 2006 was set at €226.6 million. The Bank's financial results contribute to a firm implementation of the strategic objectives set out in the CRR3.

In December 2006, the Executive Board approved the Bank's administrative budget of €267.7 million for 2007. This represents a real increase of 3.5 per cent, the first real increase since 1995.

Chart 2
Summary of the Financial Position of the EBRD in 2006

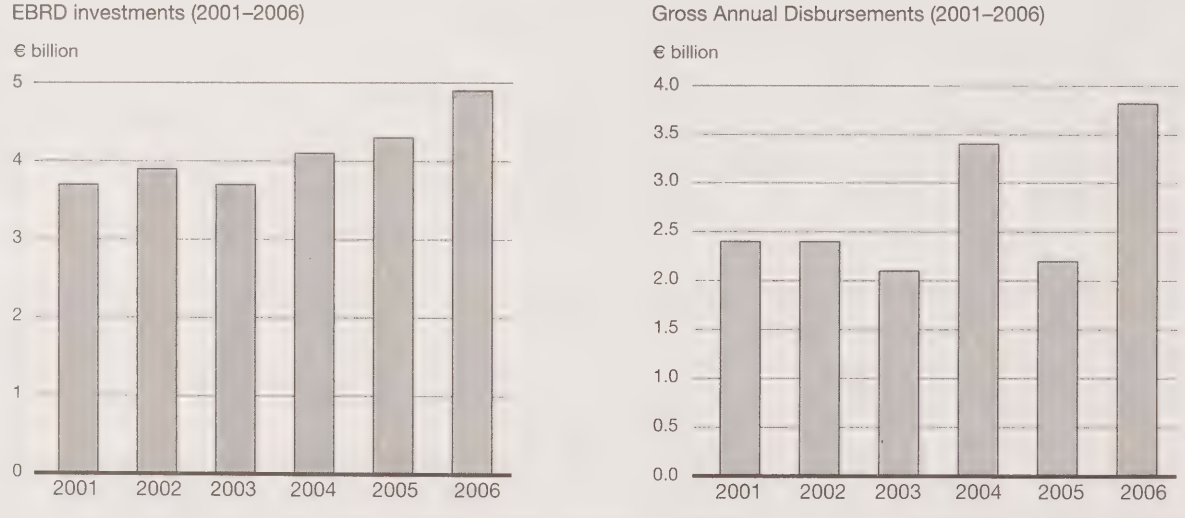
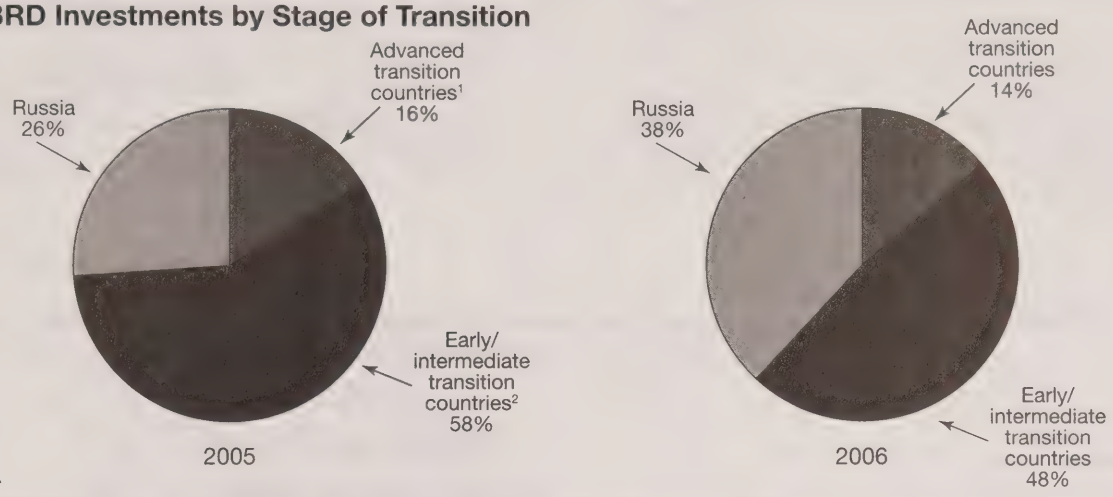


Chart 3

EBRD Investments by Stage of Transition

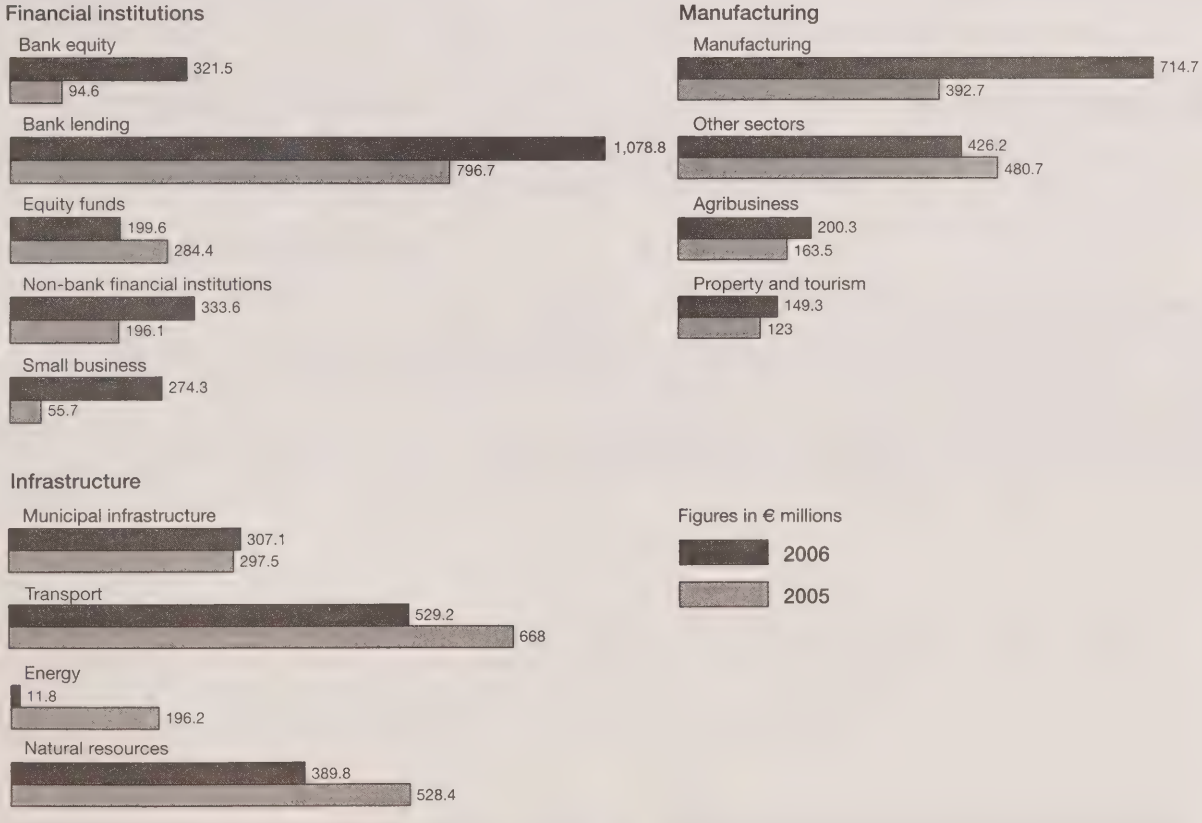


[1] Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia.

[2] Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Georgia, Kazakhstan, Kyrgyz Republic, FYR Macedonia, Moldova, Mongolia, Montenegro, Romania, Serbia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

Chart 4

Summary of the EBRD's Investments in 2006



Annual Investments: 2003–2006

	2003	2004	2005	2006
Number of projects	119	129	151	157
EBRD financing (€ million)	3,721	4,133	4,277	4,936
Resources mobilized (€ million)	5,307	8,799	6,211	8,915
Total project value (€ million)	**9,028**	**12,932**	**10,499**	**13,851**

Note: Totals may not add due to rounding.

Financial Results: 2003–2006

	2003	2004	2005	2006
			(€ million)	
Operating income	538.1	658.6	1,543.9	2,667
Expenses and depreciation	(198.6)	(189.8)	(218.9)	(225)
Operating profit before provisions	339.5	468.8	1,325.0	2,442
Provision for impairment of loans and guarantees	(11.3)	(67.2)	200.6	(53)
Net profit for the year	**328.2**	**401.6**	**1,525.6**	**2,359**
Reserves and retained earnings	911.7	1,686.0	4,656.1	6,974
Provisions for impairment of loans and guarantees (cumulative)	505.4	539.5	351.6	1,341
Total reserves and provisions	**1,417.1**	**2,225.5**	**5,007.7**	**7,315**

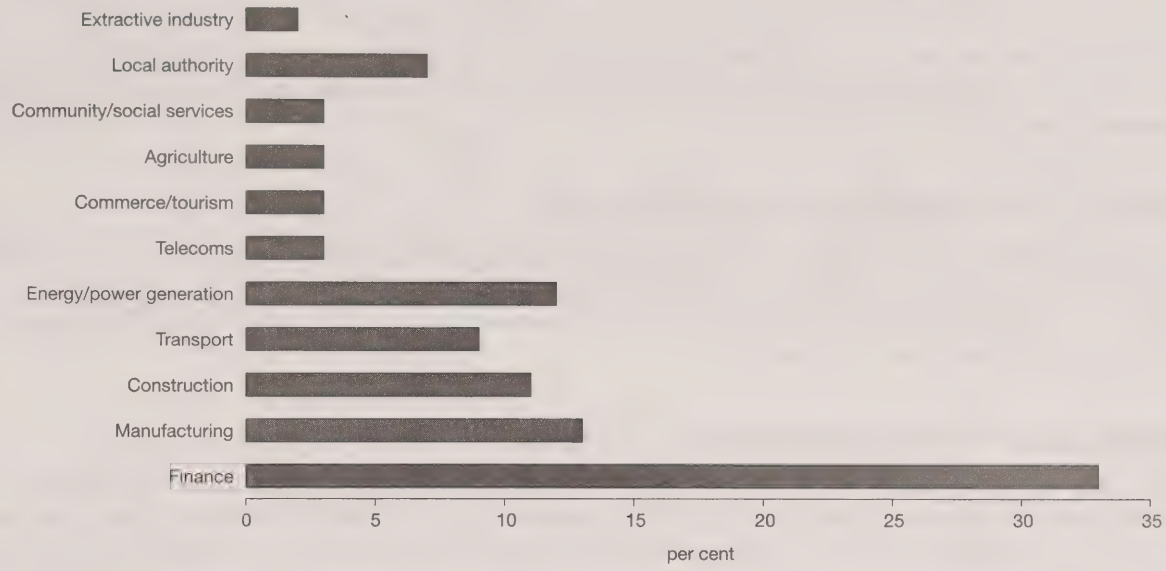
Transition Impact

The share of new stand-alone signings with a transition impact potential rated "good" or "excellent" is currently estimated to be above the base-case objective of 75 per cent and close to the upper end of the range of 80 per cent.

Portfolio Development

The reported portfolio is currently estimated at approximately €17.7 billion, up 5 per cent from 2005. Driven by a high number of new commitments in 2006, the number of active portfolio operations increased by 5 per cent to 1,283 at the end of 2006, up from 1,225 at the end of 2005. Capital utilization at the end of 2006 is estimated to be close to the ratio projected for the end of 2006 in the CRR3 at around 80 per cent.

Chart 5
2006 Portfolio by Sector



Operational Highlights[6]

The EBRD invests in virtually every kind of enterprise and financial institution, mainly in the form of loans and equity. Investments are designed to advance the transition to market economies, to set the highest standards of corporate governance and to promote environmentally sound and sustainable development. The EBRD seeks to finance only those projects that will benefit from EBRD involvement and which cannot be funded on equivalent terms by the private sector.

Environmental Investments

The EBRD invested €346 million in energy efficiency, municipal infrastructure and cleanup operations in 2005, representing 8 per cent of the Bank's total investment for the year. This generated additional environmental investment of €552 million from the EBRD's clients.

The Bank provided a further €369 million for the environmental aspects of projects in other sectors, such as manufacturing, heavy industry and agribusiness. This generated additional environmental investment of €269 million from EBRD clients.

Consultation

The Bank consulted widely with governments, industry, non-governmental organizations (NGOs), research institutes and think tanks on its draft Energy Policy in 2006. The EBRD also liaised extensively with NGOs and local communities on projects with complex environmental considerations, such as a proposed EBRD investment on Sakhalin Island.

[6] As the Annual Report went to press, the 2006 figures were not available. The following paragraphs provide a snapshot of the 2005 investment. For updates on the 2006 amounts, refer to the 2006 Sustainability Report, which will be available in the summer at www.ebrd.com/pubs/general/series/sustain.htm.

Environmental and Social Monitoring

EBRD staff made environmental and social monitoring visits to 26 projects in 14 countries in 2005. Four of these visits focused specifically on social monitoring.

In 2005, the Bank appointed its first social development expert, whose role is to work with the Bank's clients to address potentially negative social impacts and to identify opportunities to increase community benefits.

Projects With Significant Social Benefits

The EBRD invested €254 million in 2005 to promote the growth of small businesses, which are vital for the creation of new jobs and for a country's long-term growth. EBRD financing is provided through over 1,000 local banks that on-lend to small businesses. In 2005, some 480,000 loans totalling US$3 billion were provided.

Helping the Poorest Countries

In 2005, the EBRD invested €250 million in 61 projects across the seven poorest countries where the Bank operates (the early transition countries). Investment was almost three times higher than in 2004. Supported by donor funding, the Bank's investment is helping to boost business growth and alleviate poverty.

Challenges Ahead

The experience of the past decade has shown that transition is a complex, demanding and lengthy process. A market economy has to be supported by an effective institutional framework and a functioning state. In the new regions of the EBRD's operations, there are basic weaknesses in key institutions, particularly concerning finance, regulation and competition, corporate governance, and the rule of law and its enforcement. The main transition challenges in the coming years lie in creating a reliable institutional and policy environment which attracts investment flows, encourages both the growth of the new private sector and the restructuring of the old, improves the functioning of markets, fosters entrepreneurial and market skills, and strengthens the confidence of the population in the reform process. The EBRD is well positioned to address these challenges and support its countries of operations in moving towards market-oriented economies. However, as the Bank faces these challenges, it will be crucial that it continue not only to draw on its proven strengths, but also to adjust, innovate and lead by example.

Key challenges for the Bank are as follows:

- As transition proceeds at different paces across the region, the Bank will need to be effective and efficient in its allocation of funds. In the next four years, the Bank will significantly decrease its activities in the advanced transition countries and shift its focus to the east and south, where its transition efforts will have the greatest impact. The Bank must develop new, specific products that best meet the needs of its new clients and ensure that its existing expertise and tools continuously adapt to new challenges.
- In order to operate effectively and efficiently in a more complex operating environment, the Bank must continue to evolve its business model—adapting its core banking activity to dynamic transition challenges and the more difficult business environments of the early and intermediate transition countries and Russia. More resources, including staff, will need to be concentrated in the early and intermediate transition countries.
- Expanded cooperation will also be necessary to develop high-transition-impact projects with explicit social and poverty alleviation benefits in order to strengthen the willingness of governments in some of the early transition countries to move forward with politically difficult but essential reforms, particularly the restructuring or closure of large state-owned enterprises.
- Good corporate governance for all recipient countries will continue to figure prominently in the period ahead, and the EBRD will need to promote sound institutions, more efficient tax collection and improved legal and regulatory frameworks. It must ensure not only that appropriate legislation is developed, but also that it is properly implemented and enforced.
- It remains both a priority and a challenge for the EBRD to encourage adherence to good governance in line with the Article 1 principles of multi-party democracy and pluralism. In countries of operations where the commitment to Article 1 principles remains weak, notably Belarus, Turkmenistan and Uzbekistan, the Bank should continue its narrow scope of operations.
- As the region overall experiences strong economic growth and a higher inflow of foreign capital investment, the Bank will need to focus that much more on identifying projects with significant transition potential.
- A key element underpinning the Bank's ability to influence transition is the demonstration effect of its own governance policies. The Bank must continuously review and update its internal policies in order to strengthen its governance standards to meet best corporate practice.

- Continued cooperation among international financial institutions (IFIs) is necessary to create a supportive environment that furthers transition. This involves, to the extent possible, an effective articulation between policy dialogue and projects; an emphasis on transition impact, development and additionality to ensure IFI assistance is effective; and the strong mobilization of private sector capital.

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (such as *Financing With the EBRD*), special reports (such as the Annual Report and *Transition Report*), country strategies and assorted fact sheets. Information can also be obtained on the Bank's website at www.ebrd.com.

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom
(Fax: +44 20 7338 7544)

Annex 1—Summary of the *Transition Report*

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition from a centrally planned to a market economy in each of the Bank's 29 countries of operations. The *Transition Report* is recognized as the leading publication analyzing the progress of transition in the former Soviet bloc. The 2006 report focused on the evolution of the financial sector in the transition countries. The report charts the financial development that has occurred and highlights the large variation across the transition countries in terms of how credit is provided to the private sector.

Macroeconomic Overview and Reform Progress

The EBRD reports that the transition region is gradually catching up with Western Europe and other mature market economies. It finds that transition is being driven increasingly by competitive markets rather than by governments, particularly in the financial sector and in the mobile phone market. It projects 2006 economic growth of 6.2 per cent, up from 5.7 per cent in 2005 and higher than in the eurozone.

The report explains that growth was partially due to high prices and demand for oil and gas, metals and agricultural commodities of the transition region's resource-rich countries, but that it was mainly driven by domestic consumption. These factors put pressure on inflation throughout the region, to which many central banks responded with anti-inflationary measures, such as raising interest rates and introducing stricter regulations on minimum reserves. Against this backdrop, the EBRD reports fiscal policy as being too loose to stem domestic demand more effectively and calls for a more restrictive approach given the long-term implications of aging populations, which will put significant pressure on public budgets.

With domestic savings insufficient to cover investments, the Bank reports large current account deficits, especially in countries not rich in natural resources. Foreign direct investment tapered off in 2006 and several countries' currencies came under pressure in foreign exchange markets, reflecting a more critical assessment by foreign investors of vulnerabilities in the region's emerging market economies. In addition, the Bank comments that higher interest rates in 2006 in the major OECD countries diminished the appetite for investment in transition countries.

In the context of these macroeconomic challenges, the Bank reports significant progress in reform. As shown in the following table, the Bank reports 24 transition score upgrades in 16 countries and no downgrades in 2006. The Bank tracks reform developments in 29 transition countries through a set of 9 transition indicators. These cover four main elements of a market economy—enterprises, markets and trade, financial institutions and infrastructure. Market liberalization—or initial-phase reform—was reported to be virtually complete in the advanced transition countries of Central Europe and the Baltic region and in much of Southeastern Europe, but there is still room for improvement in the Western Balkans, the Commonwealth of Independent States and Mongolia. Second-phase reform—dealing with building market-supporting institutions, such as large-scale privatization, governance and enterprise restructuring, competition policy, financial sector development and infrastructure—is far from complete.

			Enterprises			Markets and trade			Financial institutions		Infrastructure
Countries	Population (millions, mid-2006)	Private sector share of GDP in %, mid-2006 (EBRD estimate)	Large-scale privatization	Small-scale privatization	Governance and enterprise restructuring	Price liberalization	Trade and foreign exchange system	Competition policy	Banking reform and interest rate liberalization	Securities markets and non-bank financial institutions	Infrastructure reform
Albania	3.2	75	3	4	2+↑	4+	4+	2	3-	2-	2
Armenia	3.2	75	4-	4	2+	4+	4+	2+	3-	2	2+
Azerbaijan	8.3	60	2	4-	2	4	4	2	2+	2-	2
Belarus	9.8	25	1	2+	1	3-	2+	2	2-	2	1+
Bosnia and Herzegovina	3.8	55	3-	3	2	4	4-	2-↑↑	3-	2-	2+
Bulgaria	7.7	75	4	4↑	3-	4+	4+	3-	4-	3-↑	3
Croatia	4.4	60	3+	4+	3	4	4+	2+	4	3↑	3
Czech Republic	10.3	80	4	4+	3+	4+	4+	3	4	4-	3+
Estonia	1.3	80	4	4+	4-	4+	4+	4-↑	4	4-↑	3+
FYR Macedonia	2.0	65	3+	4	3-↑	4+	4+	2	3-	2+	2
Georgia	4.6	70↑	4-	4	2+	4+	4+	2	3-	2-	2+
Hungary	10.1	80	4	4+	4-	4+	4+	3+	4	4	4-
Kazakhstan	15.1	65	3	4	2	4	4-	2	3	3-↑	3-↑
Kyrgyz Republic	5.1	75	4-	4	2	4+	4+	2	2+	2	2-
Latvia	2.3	70	4-	4+	3	4+	4+	3	4-	3	3
Lithuania	3.4	75	4	4+	3	4+	4+	3+	4-	3	3↑
Moldova	3.4	65↑	3	4-	2	4	4+	2	3-	2	2+
Mongolia	2.7	70	3	4	2	4+	4+	2	2+	2	2
Montenegro	0.7	65	3+	3	2	4	3+	1	3-↑	2-	2-
Poland	38.1	75	3+	4+	4-	4+	4+	3	4-	4-	3+
Romania	21.7	70	4-	4-	3-↑	4+	4+	3-↑	3	2	3+
Russia	144.1	65	3	4	2+	4	3+	2+	3-↑	3↑	3-
Serbia	8.3	55	3-	4-↑	2+	4	3+	2-↑↑	3-	2	2
Slovak Republic	5.4	80	4	4+	4-	4+	4+	3+	4-	3↑	3-
Slovenia	2.0	65	3	4+	3	4	4+	3-	3+	3-	3
Tajikistan	6.5	55	2+	4	2-	4-	3+	2-	2+↑	1	1+
Turkmenistan	6.5	25	1	2	1	3-	1	1	1	1	1
Ukraine	47.1	65	3	4	2	4	4-	2+	3↑	2+	2+↑
Uzbekistan	26.0	45	3-	3+↑	2-	3-	2	2-	2-	2	2-

Note: The classification of transition indicators uses a scale from 1 to 4, where 1 implies little or no progress with reform and 4 implies a market economy. A rating of 4+ indicates the country has achieved standards and performance typical of advanced industrial economies. An arrow indicates change from the previous year. One arrow indicates a movement of one point (from 4 to 4+, for example) and two arrows a movement of two points.

Source: EBRD, *Transition Report 2006: Finance in Transition*.

Report Focus: "Finance in Transition"

The EBRD reports that financial markets in the transition countries have grown in scope and complexity in recent years, and the performance of banks is improving. Bank lending has increased, particularly from foreign-owned banks lending to households. Stock markets are becoming an important complement to the banking system and a private equity industry is emerging, though legal and regulatory barriers still need to be overcome. The EBRD finds that due to failings in the legal framework, financial markets are less developed than in other countries with comparable income. This suggests that financial systems must develop further before the full growth potential of these economies can be exploited.

As the general institutional framework has improved in transition countries, the EBRD has observed a strengthening of the link between increasing entry of foreign banks and the efficiency and stability of the banking systems, but notes that their presence should not be seen as a substitute for institutional reforms. It points to the lack of institutional reform in areas such as creditor rights and credit registries as the main factor holding back financial development. Moreover, it comments that dominance of a relatively small number of large multinational banking groups has introduced the possibility of economic downturns or financial crises being transmitted from one country to another.

The Bank notes that improving access to financial resources for enterprises and for new businesses is still a fundamental challenge for the transition countries. Despite rapid financial development, most firms in the region still rely on internally generated funds and contributions through informal channels that are in no way linked to the formal financial system. As the transition region develops, growth will increasingly need to stem from innovation, requiring riskier and longer-term investments from financial institutions. Widening financial access will require a variety of measures, such as improving the quality of supervision of the banking system, enforcing competition policy and encouraging the growth of other financial services.

More broadly, the Bank calls for investment in improving the business climate and maintaining skill levels, for example through development of higher education and improvements to social infrastructure, as a key requisite for sustaining strong growth performance in the region. The Bank's concern is that activities such as research and product development will be centralized in corporate headquarters in the world's financial capitals, leaving local institutions with less demanding tasks and a less dynamic local workforce, thereby threatening the sustainability of long-term growth.

Annex 2—CIDA Programming in EBRD Countries of Operations

In order to increase the effectiveness of its programming, the Canadian International Development Agency (CIDA) is focusing its efforts on 25 development partners. Of those, only one is in the EBRD's region of operations: Ukraine. Efforts in the region are therefore concentrated on this country. CIDA also has active bilateral programming in the Balkans (Bosnia and Herzegovina, Serbia, and Montenegro), South Caucasus (Armenia, Azerbaijan and Georgia), Tajikistan and Russia. The timeline for disengaging from of the Balkans is 2010. The highlights of CIDA's programming in EBRD countries of operations can be found below.

Ukraine—Since 1991, Canada has provided $309.5 million in development assistance to Ukraine. CIDA's Ukraine Program focuses on democratic governance, building institutional capacity and strengthening civil society to uphold democratic practices and principles, while at the same time supporting economic well-being through improving private sector development and the enabling environment for business. CIDA will increase its engagement in Ukraine, ramping up the program over the next few years in response to the momentum generated by a new pro-reform government in that country. The Country Programming Development Framework for Ukraine will be reviewed and updated in 2007 through a process involving public consultations.

Russia—As a Group of Eight (G8) member, a nuclear power, a key partner in the fight against terrorism and Canada's largest northern neighbour, Russia is of great strategic importance. To date, Canadian technical cooperation programming expenditures in Russia total over $315 million. Current CIDA programming in Russia is focused on delivering results related to governance and economic well-being. It covers four areas: increasing public sector competence, building an enabling environment for a market economy, building an engaged civil society, and supporting sustainable regional economic development in the Russian North. CIDA's Russia Program is preparing a new Programming Framework that will manage a smaller but strategically focused program that targets governance and civil society. CIDA will emphasize a whole-of-government approach to the Canada-Russia relationship.

Balkans—The international community's strong commitment to peace, stability and cooperation in the Balkans has started to show concrete results. A fragile peace has emerged and the political discourse is increasingly focused on the future and closely bound with the institutions and prosperity of Europe and EU accession. Since 1990, CIDA has disbursed over $540 million in funding in the Balkans for approximately 800 projects. The program is focusing its efforts in countries that are key to regional stability: Bosnia and Herzegovina, Serbia (including Kosovo) and Montenegro. CIDA's Balkans Program has shifted from post-conflict technical assistance to institutional capacity building, and is directed at initiatives that contribute to public sector reform and enhance social capital in the areas of rule of law, health and education. Gender, youth, environment and refugees are all cross-cutting issues. CIDA is planning to disengage from the Balkans by 2010.

South Caucasus—Programming in the South Caucasus has been modest—approximately $57 million since 1992. Georgia has been the main recipient, with Armenia and Azerbaijan benefiting through regional programming initiatives. The majority of resources have been allocated through responsive programming in the sector of governance (political and economic). CIDA's focus is on strengthening governance structures, building institutional capacity and enhancing respect for human rights. Gender and youth are cross-cutting issues.

Tajikistan—CIDA's main area of implication is agrarian reform in the sectors of governance and strengthening of private sector development. The initiatives support:

- The development of a comprehensive regulatory system and related procedures in support of the country's agrarian reform (e.g. debt resolution, farm restructuring and land rights).
- The resolution of excessive government centralization and lack of cooperation and understanding between local authorities and communities (e.g. partnership between local governments and civil groups to manage the communities' development).
- The capacity of the State Land Committees and community organizations to monitor land reform progress.
- The critical challenge of advancing women's access to land, and ensuring their participation in their communities' decision making.
- The reorganization of agricultural enterprises in a market economy, including the use of strengthened market information systems.
- The access of farmers to micro-credit and technical assistance.

Institutional Partnership Program (IPP)—The IPP works with selected multilateral and Canadian institutional partners that are addressing issues of regional and transboundary interests in the region. The IPP focuses on the EBRD and the Organization for Security and Co-operation in Europe, working with donors and recipient countries in the sectors of governance, private sector development and environment, with gender equality as a cross-cutting theme. The IPP helps coordinate and facilitate program activities undertaken by geographic programs and collaborates closely with government departments, particularly the Department of Finance and the Department of Foreign Affairs and International Trade, to ensure policy coherence and a whole-of-government approach to the availability of financing for the private sector.

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Canada at the European Bank for Reconstruction and Development

2007

A Report on Operations Under the European Bank for Reconstruction and Development Agreement Act



Canada

Canada at the European Bank for Reconstruction and Development

2007

A Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

Department of Finance Canada
Ministère des Finances Canada

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Letter From the Minister

I am pleased to present to Members of Parliament and to the Canadian public the Department of Finance's 2007 Report on Operations Under the European Bank for Reconstruction and Development Agreement Act. This report responds to the requirement laid out in Article 7 of the European Bank for Reconstruction and Development Agreement Act that the Minister of Finance "shall cause to be laid before Parliament, on or before March 31 next following the end of each calendar year" a report containing a general summary of operations under this Act, including their sustainable development and human rights aspects. More importantly, it reflects our government's strong commitment to transparency and accountability, and our desire to promote effective and efficient international financial institutions.

Last year's report focused more clearly on Canada's policy objectives at the European Bank For Reconstrcution and Development (EBRD), which can be summarized as:

1. Promoting good governance and accountability.
2. Ensuring institutional effectiveness.
3. Promoting the environmental sustainability of EBRD projects.
4. Advancing Canadian commercial interests.

In the 2007 report, we describe Canada's achievements in meeting these priorities. In addition, for the first time, the report takes a forward-looking view and identifies Canada's future priorities over a three-year period to provide the reader with a better understanding of our objectives with respect to the EBRD. The report also identifies additional actions going forward.

The format of this report draws on improvements made last year. The improvements are based on feedback received from parliamentarians and civil society on this report and its companion report (the Report on Operations Under the Bretton Woods and Related Agreements Act). The 2007 report has been recast with three goals in mind:

1. To make Canada's policy objectives with respect to the EBRD clearer, making it easier to measure the success of Canada's relationship with the institution. To this end, the 2007 report includes specific actions that Canada will advocate at the Board of Directors and the Annual Meetings.
2. To have Canada continue to push the frontiers of disclosure, without violating Canada's requirement to respect the confidentiality policies of the EBRD.
3. To reach out to a wider audience, especially professionals and students with an interest in international development.

It is my hope that this report will provide parliamentarians and all Canadians with a better understanding of the role that Canada is playing in the institution and in helping to ensure that the EBRD achieves its important transition mandate.

The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance

Mandate and Role of the EBRD

Overview

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aims are to foster the transition toward open, market-oriented economies in Central and Southeastern Europe, as well as in the successor states of the former Soviet Union,[1] and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multi-party democracy, pluralism and market economics.[2] To deliver on its mandate, the Bank focuses its activities on assisting its 29 countries of operations in implementing economic reforms, taking into account the particular needs of countries at different stages in the transition process. Through its investments, and in line with its Articles of Agreement, the EBRD promotes democratic institutions and human rights in its countries of operations.

The Bank's overriding focus is the private sector, with a strong operational emphasis on enterprise restructuring, including the strengthening of financial institutions, and the development of the infrastructure needed to support the private sector. The EBRD's charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. All of its financing projects have to demonstrate environmental sustainability, as per the Bank's Articles of Agreement. The Environmental Policy is reviewed every three years to ensure the Bank adopts state-of-the-art best practices in all projects.

In promoting economic transition, the Bank acts as a catalyst for increased flows of financing to the private sector, as the capital requirements of these countries cannot be fully met by official multilateral or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the central Asian republics. For example, in 2007, for every euro the EBRD invested, it mobilized an additional 1.7 euros from the private sector and other multilateral and bilateral agencies.

The EBRD's operations to advance the transition to a market economy are guided by four principles: transition impact, additionality, sound banking and environmental sustainability. Financing is provided for projects that expand and improve markets, help to build the institutions that underpin a market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also mobilize additional sources of financing and not displace them. Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers attractive returns. Adherence to sound banking principles also ensures the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector. Finally, the Bank helps to ensure that environmental sustainability is reflected in all of its projects.

The Bank's medium-term operational priorities are premised on: the central importance of creating and strengthening those institutions that ensure markets work well; the key role that small businesses can play in creating dynamic, competitive and more equitable economies; and the key role the transition process plays in applying the principles of multi-party democracy and pluralism.

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[1] In 2006, all members formally accepted Mongolia as the Bank's country of operations.

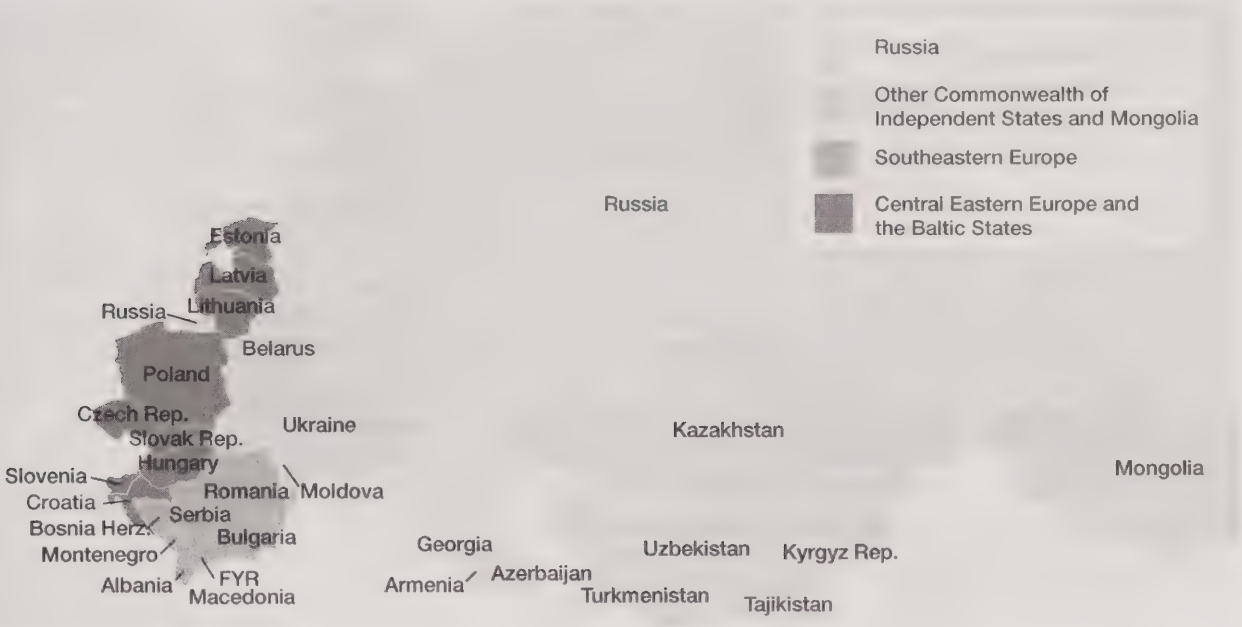
[2] Article 1, Agreement establishing the European Bank for Reconstruction and Development.

To achieve these priorities the Bank focuses on:

- Promoting transparency and accountability in public sector management.
- Developing sound financial sectors linked to the needs of enterprises and households.
- Providing leadership for the development of micro-lending and small and medium-sized enterprises.
- Developing market-based and commercially oriented infrastructure.
- Demonstrating, through selected examples, effective approaches to restructuring viable large enterprises.
- Taking an active approach in its equity investments to improve corporate governance.
- Engaging governments in policy dialogue to strengthen institutions and improve the investment climate.
- Taking a regional approach where appropriate.
- Promoting sustainable development and environmental due diligence.

Countries of Operations

The EBRD has 63 members: 61 countries, the European Community and the European Investment Bank. There were 29 countries of operations last year.[3]

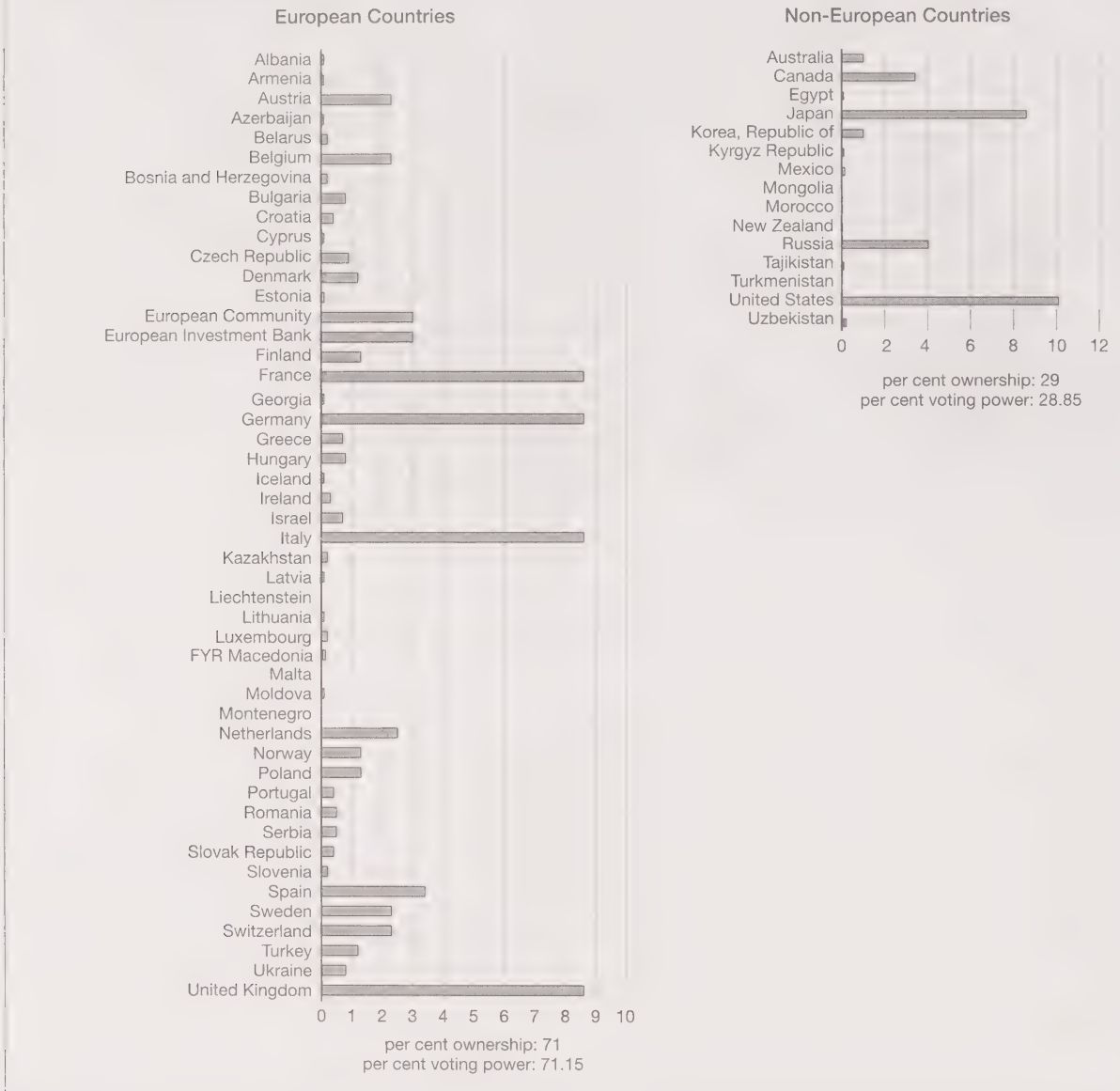


[3] The Czech Republic ceased to be a country of operations in December 2007.

EBRD Membership

The EBRD's share capital is provided by member countries, with proportional voting rights. The EBRD's authorized capital is €20 billion—Canada's capital share is 3.4 per cent.

Chart 1
EBRD Membership



EBRD Governance and Oversight

The highest authority in the Bank is the Board of Governors. It meets annually and approves the institution's annual report, net income allocation, financial statements and independent auditor's report, and the election of the Chair and Vice-Chair for the next Annual Meeting, as well as other items requiring Governors' approval. A Governor and an Alternate Governor represent each of the 63 shareholders.

The Board of Directors is responsible for the general operations of the Bank. It is composed of 23 members, with each representing either one member country or a constituency of member countries. The Board helps to set the strategic and financial course for the Bank, in consultation with management.

Board Committees

The Board has established four committees that are responsible for overseeing the activities of the Bank's management team: the Board Steering Group, and the Audit, Budget and Administrative Affairs, and Financial and Operations Policies Committees. This division of labour is consistent with good corporate governance practices and provides an appropriate system of checks, balances and incentives. In addition, the structure ensures a more effective discussion by the Executive Board, once initiatives are ready for approval.

The Board Steering Group is responsible for the coordination of the Committees' work programs to avoid overlap and ensure timely completion. The Chair of the Group manages the nomination processes for Committees. The Group is currently chaired by the Canadian Director.

The Audit Committee's primary objective is to ensure that the financial information reported by the Bank is complete, accurate, relevant and timely. The Committee oversees the integrity of the Bank's financial statements and the compliance of its accounting and reporting policies with the requirements set out in the International Financial Reporting System. It also reviews the EBRD's system of internal controls and its implementation, as well as the functions of the internal audit, evaluation and risk management teams. The Committee is currently chaired by the UK Director.

The Budget and Administrative Affairs Committee is responsible for ensuring that the Bank's budgetary, staff and administrative resources are aligned with its strategic priorities. To this end, the Committee reviews the medium-term resource framework, annual budgets and business plan. It also oversees the Bank's human resources policies, including ethics. The Committee is currently chaired by the German Director. The Canadian Director is a member of the Committee.

The Financial and Operations Policies Committee oversees the Bank's financial policies, including the annual borrowing plan prepared by the Treasury Department. The Committee also reviews country strategies and proposed projects. The Committee is also responsible for the transparency and accountability of the Bank's operations, as laid out in the 2006 Public Information Policy. Since 2007, the Committee has also been charged with overseeing the net income allocation process. As well, it is responsible for the renewal of the Bank's Environmental Policy. The Committee is currently chaired by the Hungarian Director.

How the EBRD Works

Project Finance

The EBRD offers a full array of financial products and services, including:

- Longer-term loans.
- Equity investments.
- Quasi-equity instruments (subordinated loans, preferred stock, income notes).
- Guarantees and standby financing.
- Risk management (intermediation of currency and interest rate swaps, provision of hedging facilities).

Eligibility

Eligible projects must be supported by a strong business case, benefit the economy and the transition process of the host country, and comply with the EBRD's environmental guidelines. Projects in all industries are eligible for EBRD financing, except those producing military equipment, tobacco and distilled alcohol. Although it is primarily a financier of private sector projects, the Bank may provide finance to state-owned companies, provided they are operating competitively and, in particular, that such financing facilitates or enhances the participation of private and/or foreign capital in such enterprises. The EBRD can finance private companies that are wholly locally owned or foreign-owned, as well as joint ventures between foreign and local shareholders.

In order to ensure the participation of investors and lenders from the private sector, the EBRD limits the total amount of debt and equity financing for any single project to 25 per cent of total estimated project costs. However, in certain circumstances, it may provide up to 35 per cent of the equity capital for a project, provided it is never the largest shareholder.

EBRD investments range from €5 million to €250 million.[4] Smaller projects are financed both directly by the EBRD and through local financial intermediaries. By supporting local commercial banks, micro-finance organizations, equity funds and leasing facilities, the EBRD has helped finance over 1 million smaller projects.

Fees

The EBRD charges market rates for its private sector financing and provides uniform loan pricing for sovereigns of LIBOR (London Interbank Offered Rate) +100 basis points. In addition, fees vary according to the nature of the project and the amount and complexity of the work required of the EBRD.

Funding of EBRD Activities

The EBRD's equity and quasi-equity investments are funded out of its net worth—the total of paid-in capital and retained earnings. Of the funding required for its lending operations, 100 per cent is borrowed in the international financial markets through public bond issues or private placements. The EBRD's bond issues have been given AAA rating by both Moody's Investors Service and Standard & Poor's.

[4] This amounts to C$7.35 million to C$367 million, based on the 2007 exchange rate.

Policy Dialogue

The Bank uses its close relationship with governments in the region to promote policies that bolster the business environment. The EBRD advises governments on promoting a sound investment climate and stronger institutional framework, which are important for the functioning of the private sector. This dialogue is typically part of the project the Bank participates in. Specifically, the EBRD works with government officials to promote sound corporate governance, anti-corruption practices, fair and predictable taxation policies and transparent accounting standards. In addition, a dedicated legal team advocates for an effective legal and regulatory framework which is not directly tied to a project.

Technical Assistance

Technical assistance improves the preparation and implementation of the EBRD's investment projects and provides advisory services to private and public sector clients. It increases the impact of EBRD projects on the transition process by supporting structural and institutional changes, and assists legal and regulatory reform, institution building, company management and training. Technical assistance is important to the Bank as it allows thorough preparations for the investments, more effective investments in general, and investment opportunities in higher-risk environments in particular.

> Technical assistance projects are funded by governments and international institutions and managed by the EBRD.

Project Cycle

The EBRD's bankers and their project leaders have the primary responsibility for ensuring a project's compliance with four principles: transition impact, additionality, sound banking and environmental sustainability. However, to ensure that projects continue to generate a significant transition impact, risk management and evaluation groups provide independent advice, lessons learned, and monitoring and review functions throughout the project cycle.

Canada's Representation at the EBRD—The Honourable James M. Flaherty, Minister of Finance, is the Canadian Governor and Mr. Leonard J. Edwards, Deputy Minister of Foreign Affairs, is the Alternate Governor. Canada's representative on the EBRD Board of Directors is Mr. André Juneau. The Canadian Director represents our constituency, which includes Morocco. The Minister (Economic/Commercial) at the Canadian High Commission in London, Ms. Judith St. George, is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

Canadian Staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2007 there were 23 Canadian professionals on the staff of the EBRD, representing 3.4 per cent of total professional positions, equal to Canada's 3.4 per cent share of the institution's capital. Canadians fill the following senior positions: Director of Communications, Deputy Chief Compliance Officer, and Director of the Early Transition Countries Initiative.

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (such as *Financing With the EBRD*), evaluation reports, special reports (such as the annual report and *Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's website at www.ebrd.com.

Requests for information can be addressed to

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Fax: +44 20 7338 7544

Canada at the EBRD

Benefits of Membership

Canada's membership in the EBRD, and its active participation in the discussion of policy and operational issues, are an important means to help shape regional norms and rules in the EBRD's 29 countries of operations. By supporting continued political and economic reform in Central and Southeastern Europe and the former Soviet Union, Canada is contributing to the region's stability and integration into the world economy.

Canada shares with the Bank the overriding objective of developing a strong private sector in its countries of operations, by mobilizing financing for projects with a high transition impact, and by providing advice and technical assistance to businesses and governments. Through its participation in the EBRD's Board of Directors, Canada has been able to press for greater attention to governance issues in the Bank's operations. Moreover, Canada has been able to help shape the environmental and social safeguards that govern the EBRD's lending. The Bank also provides Canada with a vehicle to reach poor transition countries that are not normally part of our bilateral development assistance programs.

Canada is also interested in raising awareness among Canadian companies about the EBRD. Canadian companies can seek financing for projects undertaken in the Bank's countries of operations. In addition, in order to implement transition projects, the Bank often relies on goods and services from its members through procurement. This allows Canadian firms to have access to different markets and enjoy commercial opportunities they may not have had otherwise. For example, consulting services is an area where Canada has a comparative advantage and where Canadians have been successful in winning EBRD-financed contracts.

Role of Canadian Government Departments

Within the Canadian government, responsibility for oversight of the EBRD's activities resides with the International Finance and Development Division of the Department of Finance. In consultation with the Department of Foreign Affairs and International Trade and the Canadian International Development Agency (CIDA), the Department of Finance regularly reviews the Bank's policy papers and proposed country strategies, and provides advice to the Canadian Director.

Contribution to Ordinary Capital Resources

At the end of 2007, the total authorized capital of the Bank was €20 billion. Canada's share is 3.4 per cent—or €680 million (C$1 billion), of which 25.3 per cent, or C$252.7 million, is paid in. The remainder is callable and would be provided only in the unlikely event that the institution would face severe financial difficulty. Canada's paid-in contribution is treated as a non-budgetary expenditure, as shares in the Bank are considered an asset.

Canada's paid-in capital is being provided in a series of instalments of cash and non-interest-bearing demand notes, which are then encashed over a five-year period. Payments are made in eight equal annual instalments (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). Canada's last note encashment will be made in 2009.

Table 1
Canadian Payments to the EBRD

Year	Total cash payments in US$ (includes note encashment and cash payments)	Total cash payments in C$[1] (includes note encashment and cash payments)
1991	23,807,004	27,278,065
1992	15,871,336	19,177,335
1993	19,839,170	25,588,561
1994	23,807,004	32,517,987
1995	23,807,004	32,677,494
1996	7,935,668	10,821,077
1997	3,967,334	5,492,325
1998	6,315,572	9,366,645
1999	7,773,010	11,549,451
2000	9,230,449	13,709,085
2001	10,687,891	16,549,305
2002	12,145,331	19,072,539
2003	12,145,331	17,021,217
2004	12,145,331	15,807,394
2005	12,145,331	14,715,677
2006	5,829,759	6,611,492
2007	4,372,320	4,699,291[2]
2008	2,914,880	3,132,861[2]
2009	1,457,440	1,566,430[2]

[1] Exchange rates are based on Bank of Canada annual noon exchange rate averages.

[2] 2007 exchange rate used as an estimate.

EBRD Transactions in Canada or in Canadian Currency

The EBRD did not issue debt in Canadian currency in 2007.

Contribution to Special Funds

As part of a loan or equity investment, the EBRD often provides its clients with advice on how to improve the project by ensuring thorough preparation and effective implementation. This advice is often paid for out of special funds, which are set up by donor countries and international institutions and are managed by the Bank. These funds mobilize investment capital and expertise in the EBRD's countries of operations by giving local business access to consultant experts. The consultants assist in the preparation of projects and strengthen local management know-how. They also develop environmental strategies and work to improve the legal framework in which businesses operate. Canada has contributed to the following special funds:

Early Transition Countries Multi-Donors Fund—CIDA is one of 12 donors to this fund, which was launched in 2004 and targets Bank programming in the poorest countries of the EBRD's operations (Mongolia, Moldova, Azerbaijan, Armenia, Georgia, Tajikistan, the Kyrgyz Republic and Uzbekistan). This fund is the first EBRD funding mechanism to be classified Official Development Assistance by the Development Assistance Committee of the Organisation for Economic Co-operation and Development. Canada has contributed C$1.7 million to this untied fund.

Canadian Technical Cooperation Fund—The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects across a wide range of sectors and EBRD countries of operations. Canada has transferred C$19 million to the EBRD for technical cooperation since 1992. Canada's contribution was renewed in 2006 for an additional three years, until 2009, and includes technical cooperation in Armenia, Georgia, Russia and Ukraine. The sectors of focus include: environment, private sector development and municipal governance.

Chernobyl Shelter Fund—The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this 10-year project is roughly US$1.1 billion, of which US$716 million has been pledged so far. Canada has pledged US$33 million, including US$0.8 million of bilateral assistance for ventilation stack repair.

Nuclear Safety Account (NSA)—This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operations until the plants can be closed. The NSA complements other bilateral and multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of US$280 million. Canada's contribution has been completely disbursed.

CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE)—By 2002, Canada had contributed C$10 million in support of the EBRD's South Eastern Europe Action Plan, to be used for technical cooperation and co-financing activities. These funds were used in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, Serbia, and Montenegro, and supported activity by Canadian consultants. In 2003, an additional C$6 million was added to the CFSEE, which focuses on CIDA priority sectors and countries of focus. CIDA is participating, through the CFSEE, in the Western Balkans Initiative, which includes within its scope a multi-donor technical cooperation fund and is intended to improve donor coordination arrangements in the Western Balkans.

TurnAround Management Programme—The TurnAround Management Programme was established in 1993 to match senior industrial advisors from market-driven economies with chief executives of selected firms in the region that are in financial difficulty. The objective is to provide management know-how and develop business skills so that these companies can become competitive and profitable. Canada has contributed C$3 million to this fund.

Technical Assistance in Support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II—Canada agreed to provide C$3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. To date, C$2.12 million has been transferred to the Bank for technical assistance that includes risk- and loan-evaluation training. The Fund is now being used in support of the Mortgage Lending Framework focused on local banks' capacity building.

Northern Dimension Environmental Partnership—Canada is the sole non-European contributor to this fund, which provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Canada has committed C$20 million, which is earmarked for the facility's "nuclear window" and counts toward Canada's commitment to the G8 Global Partnership Program.

CIDA-EBRD Cooperation Fund for Central Asia and the South Caucasus—This C$2-million fund was created in 2004 for work on project preparation and implementation activities in Central Asia and the South Caucasus. The fund targets the following sectors: agribusiness, natural resources, infrastructure financing (e.g. transport, telecommunications, municipal finance), and strengthening institutional capacity development of local institutions working in private sector development and micro-lending institutions. This is the first Canadian bilateral fund at the EBRD that untied 100 per cent of Canada's assistance (i.e. procurements are not limited to Canadians).

Canada at the EBRD: What Happened in 2007

Canada's Priorities in 2007

In the 2006 annual report, we identified Canada's priorities for 2007, which were: (1) promoting the highest standard of governance; (2) commitment to Article 1 regarding engagement in Belarus; (3) promoting a strong transition focus and a sound investment climate; (4) environmental stewardship; and (5) advancing Canadian commercial interests. In this section, we describe specific actions that were taken in 2007 in support of Canada's priorities.

1. Governance and Accountability

A key element underpinning the Bank's ability to influence transition in its countries of operations is the demonstration effect of its own governance policies. As a result, Canada has pressed the Bank to adopt the very highest standard of internal governance. In 2006, the EBRD broadened its public disclosure policy, in line with modern corporate governance practices. The Bank now discloses minutes of Board of Directors meetings, posts on its website project summary documents and a list of policies and strategies scheduled for development or review in the year ahead, and provides a summary of the annual staff compensation and benefits proposals. In 2007, as required under the revised Public Information Policy, the EBRD held public consultations on its Hungary country strategy, which defines the Bank's activities in the country over the next three years. Comments received from the public were incorporated into the final strategy. Going forward, Canada will continue to advocate for the Bank to follow the same process for all its country strategies.

2. Commitment to Article 1—Engagement in Belarus

The EBRD has an explicit political mandate, set out in Article 1 of the Agreement establishing the EBRD, which is to foster transition in countries that are committed to and applying the principles of multi-party democracy and pluralism. In countries with poor democratic and human rights records, the Bank limits its scope of activities to the financing of the private sector while continuing to seek ways of improving the investment climate and supporting reform efforts. Canada strongly supports this mandate and has continuously stressed its application. For example, in 2006, during the review of the Belarus country strategy, Canada took a strong stand in favour of a vigorous interpretation of the Bank's responsibilities under Article 1. And, as a result of pressure exerted by the Bank's shareholders, the EBRD's new strategy in the country focuses exclusively on the financing for the private sector. In 2007, the Bank approved only seven projects in Belarus, all focused on small and medium-sized enterprises, as well as the investment enabling framework for the financial sector. Over the coming years, Canada will continue to monitor EBRD activities in Belarus to ensure that they are consistent with the country strategy.

3. Maintaining a Strong Transition Focus

Canada played an active role in the development and discussion of the EBRD's third Capital Resources Review, stressing the need for the institution to move decisively to increase its operations in the early transition economies of the former Soviet Union and Southeastern Europe. At the 2007 Annual Meeting, Canada supported an allocation of 2006 net income to reserves so the Bank could pursue higher-risk projects that are essential for transition in these countries.

In the fall of 2007, the Board of Directors undertook an intense program of analysis reviewing the Bank's business potential until 2010, capital adequacy, possible other uses (i.e. technical assistance and investment grants to support banking, funds for nuclear safety), and distribution of dividends, as possible options for allocating 2007 profits. Ultimately, Directors will recommend a decision on which Governors will vote at the 2008 Annual Meeting. Going forward, Canada will continue to press the EBRD to use its capital base for activities that generate strong transition impact and are consistent with the Bank's mandate.

4. Environmental Stewardship

In 2006, Canada supported an expanded role for the EBRD on the issues of climate change and increased energy security. As one of the fastest-growing parts of the world, the EBRD region has a growing demand for energy. One of the major challenges facing the region is inefficient use of energy—a legacy of the former command economies that causes environmental and economic damage and contributes disproportionately to climate change. In fact, the Bank estimates that the transition region uses up to seven times more energy per unit of gross domestic product (GDP) than Western Europe. In 2007, the Bank approved a first clean-coal project in Mongolia, which will set standards of transparency and sustainable environmental conduct. Specifically, the project will improve corporate environmental management practices through the preparation of the first ever mine closure plan for a Mongolian mining company, in compliance with the EBRD's environmental and social assessment plan. The project will also ensure that the company's business practices are consistent with the Extractive Industry Transparency Initiative. Over the medium term, Canada will continue to support the Bank's efforts in selecting sustainable projects that promote best environmental and social practices.

> At the 2006 Annual Meeting, Governors launched the Sustainable Energy Initiative, which commits the EBRD to investing €1.5 billion in energy efficiency and renewable energy projects over the next three years. It also commits the Bank to strengthening policy dialogue with governments and to working with donors to support sustainable energy projects.

5. Advancing Canadian Commercial Interests

The EBRD offers a number of investment opportunities for Canadian businesses and financial institutions. One of the objectives of the Canadian office is to increase Canadian awareness of these investment opportunities, explain how the Bank's financing mechanisms work, and ensure that EBRD policies and procedures are followed in a transparent and fair manner.

To achieve this objective, the Canadian office provides EBRD market information and intelligence to Canadian firms and advises Canadian project sponsors on EBRD financing options. In addition, the office develops commercial co-financing opportunities with Export Development Canada and other Canadian financial institutions. Together with the Department of Foreign Affairs and International Trade and Industry Canada, the office also identifies EBRD procurement opportunities and, with CIDA, promotes Canadian technical cooperation activities and official co-financing with the EBRD. Going forward, the Canadian office will continue to organize business events that raise awareness among Canadian companies about opportunities with the EBRD.

The following events in 2007 were supported by the Canadian Director's office and promoted Canada's interests:

- The Canadian Director, Business Advisor and the First Vice President, Varel Freeman, met with Canadian oil and gas businesses in Calgary and general corporates, including forestry, in Vancouver to present the work of the Bank and to discuss possible partnerships in February 2007.
- On the Canadian outreach side, the Canadian Director and the Business Advisor organized the visit of EBRD President Jean Lemierre to the Conférence de Montréal in June 2007 and arranged a business program, including additional meetings with Canadian corporates interested in investment in the Bank's region. The President also attended meetings with senior government officials in Ottawa.
- As in previous years, a senior natural resource banker participated in the Prospectors and Developers Association of Canada annual event in Toronto.
- The Business Advisor and a senior natural resource banker participated in a Private Sector Roadshow in Vancouver, Calgary, Toronto and Montréal. This event raised awareness for Canadian companies interested in investing and doing business in the region.
- The EBRD's Deputy Chief Economist and Director, Strategy and Analysis and the Canadian Policy Advisor travelled to Toronto and Ottawa to present to business, academics and government officials key findings of the Bank's 2007 *Transition Report* on developments in the business and economic environments of the Bank's countries of operations.
- In addition, the Canadian office at the Bank in London received a steady stream of business visitors from Canada and supported them in their dealings with the EBRD.

Canada's Voting Record in 2007

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board of Directors. As a result, decisions at the Board are generally taken by consensus. Directors may, however, abstain or vote against projects or policies in consultation with their constituencies. The Canadian Director supported all policies in 2007, as well as the vast majority of the 262 projects approved by the Board. There were 14 exceptions, which reflected four main reasons.

- **Lack of additionality.** Additionality is one of the EBRD's core operating principles, whereby project investments support private investors without crowding them out. Typically, concerns are raised if it is possible that an investor might have access to private sector funding on reasonable terms. The Canadian Director abstained or voted against five projects on these grounds.

  1. An EBRD loan to a Russian bank (MDM Bank) to support its lending activities.
  2. An EBRD loan to Kaufland Romania to enable expansion of its store chain throughout the country.
  3. An EBRD loan to a Kazakhstani bank (Kazkommertsbank) for on-lending for residential mortgages and for construction projects outside the oil and gas sector.
  4. An EBRD investment in class C and D notes to be issued by a special purpose vehicle as part of the securitization of the Erste Leasing auto loan portfolio in Hungary.
  5. An EBRD equity investment in a Russian company to construct a power cable company in Russia.

- **Lack of transition impact.** Helping to move a country closer to a full market economy (the "transition impact") is another of the EBRD's core operating principles. As per Article 2 of the Agreement establishing the EBRD, transition is fostered through various measures including: promoting the establishment, improvement and expansion of productive, competitive and private sector activity and the mobilization of capital and experienced management to this end; fostering productive investment, including in the service and financial sectors, and in related infrastructure where necessary to support private and entrepreneurial initiative; providing technical assistance; and supporting multinational projects and/or projects with more than one donor country. Concerns are raised whenever it is anticipated that an investment will not achieve an incremental transition impact on these terms. The Canadian Director abstained or voted against three projects on these grounds.

  6. An EBRD equity investment to support a capital increase to a Slovenian bank.

  7. An EBRD equity investment in a Russo-Ukrainian property partnership to develop a mix of office, retail, industrial and residential properties.

  8. An EBRD equity investment in BaltCap Private Equity Fund L.P. to enable equity and equity-related investments in companies headquartered, incorporated or having a majority of their assets, sales or operations located or generated primarily in Estonia, Latvia and Lithuania.

- **Inconsistency with Canada's policy on steel.** Canada does not support steel projects at multilateral development banks that contribute to excess global capacity, given there is already global oversupply. The Canadian Director abstained or voted against two projects on these grounds:

  9. An EBRD loan to a Russian company (Chelyabinsk Tube Rolling Plant) for the construction of a steel mini-mill to produce billets for seamless pipes.

  10. An EBRD loan to a Polish company (Celsa Huta Ostrowiec) for expansion of its existing plant.

- **Concern over the business environment in countries of operations.** Country strategies describe the Bank's three-year plan of engagement in its countries of operations. Specifically, they provide an assessment of a country's progress towards transition and identify key areas where the Bank can provide assistance. The country strategy for Bulgaria was being reviewed in 2007. The Canadian Director had concerns with aspects of the business environment in the country and did not want to vote on projects in Bulgaria until the new strategy was adopted (properly noting the problems). The Canadian Director abstained or voted against four projects on these grounds:

  11. An EBRD loan to a state-owned Bulgarian company (Plovdiv Regional Water Company) for the rehabilitation of the water supply and wastewater infrastructure.

  12. An EBRD loan to a Bulgarian power company (Vez Svoghe) for the construction and operation of nine small hydro plants along the river Iskar.

  13. An EBRD loan to the Fund for Energy and Energy Savings that will enable the purchase of receivables under energy saving contracts in Bulgaria.

  14. An EBRD equity investment in a Bulgarian pulp mill company (Svilosa A.D.) for expansion of its business.

Summary of the EBRD's Operations in 2007

2007 marked the second year of the Bank's operations under the new business model, the third Capital Resources Review (CRR3), which focuses EBRD operations in the East and South of Europe[5] and commits the institution to a gradual phase-out of Central European countries. By 2010, the 8 countries that acceded to the European Union in 2004[6] (the EU8) will graduate from the Bank's lending program, and the remaining 21 EBRD countries of operations will be from the East and South of Europe. The Bank's operations in these countries differ significantly from its involvement in the EU8: major projects centre on the energy sector and more of the portfolio is oriented toward smaller projects that require greater oversight and more proactive capacity building.

CRR3

CRR3 was approved by Governors at the 2006 Annual Meeting and covers the period between 2006 and 2010.

CRR3 mapped out how the Bank could best meet the needs of its clients within its mandate. It identified the tools that the EBRD could use to ensure strong development results and also prescribed the financial discipline that was required to guarantee sustainability of the Bank's operations. Given the growing demand for EBRD services in the early and intermediate transition countries, the emphasis was placed on shifting the Bank's core activities to the South and East of Europe and gradually phasing out the eight countries in Central Europe that benefited from EBRD support early in their transition process.

The operational objectives of CRR3 are to develop the portfolio in line with a base case target of €21.9 billion by 2010, and to achieve an annual business volume of around €3.6 billion. The geographical composition of the annual business volume is projected to shift in line with the strategic direction of CRR3, as the portfolio share of early and intermediate transition countries and Russia is set to grow to around 87 per cent by 2010.

Recognizing that the new group of clients faces different challenges than the EU8, the Bank has begun to develop new approaches to doing business. In particular, greater emphasis is being placed on good governance and the need for companies to follow best practices. To ensure effectiveness of meeting its transition objectives, the Bank, in addition to improvements to its own internal policies and strategies, is including corporate governance plans as part of the project preparation and is encouraging its clients to disclose company information. The Bank has also increased its financing for technical capacity building to enable the development of the regulatory and legal frameworks necessary for private sector development. In 2007, the Bank spent a98 million7 on technical assistance, on:

- Consultancy services for feasibility studies as part of project preparation.
- Procurement assistance during project implementation.
- Development of management skills under the Bank's TurnAround Management Programme.
- Legal advice to improve legislation and corporate governance and to promote regulatory development.

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5 East: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Mongolia, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan. South: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Montenegro, Romania, Serbia.

6 Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia.

7 This amounts to C$144 million, based on the 2007 exchange rate.

The number of projects in non-EU8 transition countries now represents 56 per cent of the Bank's portfolio and Russia accounts for 29 per cent. By 2010, the non-EU8 region and Russia will represent 87 per cent of the Bank's operations. Despite the increase in higher-risk projects (now accounting for almost 23 per cent of all operations), in 2007 the share of new stand-alone signings with a transition impact potential rated "good" or "excellent" totalled almost 90 per cent. To further minimize reputation and integrity risks, management—and increasingly the Executive Board—is relying on the Office of the Chief Compliance Officer to ensure that the highest levels of ethical standards are maintained in all of the Bank's operations. In 2007, the Office prepared 240 integrity reports. In addition, the Evaluation Department published 10 reports on the Bank's participation in sectors where the EBRD is becoming more involved, and which will be the core of its activities going forward (e.g. water supply and sewage services, energy sector, micro and small enterprises sector). The key findings should further assist management in improving the effectiveness and efficiency of projects.

To support the ongoing shift in operations, the 2007 operating budget of €293.6 million enabled the Bank to hire additional staff to further strengthen its presence in regional offices, prepare new sustainable projects in key sectors where the Bank has increased its participation, and improve analysis and knowledge of horizontal issues such as climate change and clean energy. These resources will enable the Bank to further align its operational needs with its mandate.

Yet, transition is a complex, demanding and lengthy process. A market economy has to be supported by an effective institutional framework and a functioning state. In the new regions of the EBRD's operations, there are basic weaknesses in key institutions—particularly concerning finance, regulation and competition, corporate governance, and the rule of law and its enforcement. The main challenges for the transition process in the coming years lie in creating a reliable institutional and policy environment that attracts investment flows; encourages the growth of the new private sector and the restructuring of the old; improves the functioning of markets; fosters entrepreneurial and market skills; and strengthens the confidence of the population in the reform process. To better understand the attitudes of clients toward democracy and economic reforms, the Bank conducted—with partial funding provided by Canada—a Life in Transition survey, which measures peoples' satisfaction with democracy and economic outcomes of transition. The key findings could assist the Bank in fine-tuning the tools it uses to develop a sustainable private sector (see Annex 2 for details).

Many transition challenges remain in the Bank's countries of operations in the South and East. While the Bank has a strong record of success, going forward it will be crucial that the institution remains focused, selective and driven by strong transition results.

Challenges Going Forward

- For the last two consecutive years, a high growth in the Bank's portfolio has exceeded the projections of CRR3.[8] The increasing demand for EBRD services requires that the Bank be more selective in the projects it finances and that it continue to focus on the importance of choosing quality over quantity. Going forward, the Bank's activities must be realigned with its core mandate of fostering the transition to market principles in its 28 client countries. This may include a greater focus on projects that promote environmental standards and good labour practices.
- The 2007 *Transition Report* indicates that the commitment to democratic reforms in the region has weakened. It remains both a priority and a challenge for the EBRD to encourage adherence to good governance in line with the principles of Article 1 regarding multi-party democracy and pluralism. In countries where the commitment to Article 1 remains weak, the Bank should continue its narrow scope of operations. In countries where governments are entering the most difficult stages of reform, the Bank should develop high transition impact projects with broader social benefits.
- At the 2006 Annual Meeting, Governors approved the Bank's plan for a gradual withdrawal from the EU8 countries by 2010. After the graduation process is completed, the Bank will stop doing new business in those countries, while monitoring existing projects for compliance with Board decisions. The graduation of the Czech Republic signalled the country's progress in achieving transition to a full market economy and democracy. As well, the EBRD has closed three offices in Estonia, Latvia and Lithuania. Over the next two years, shareholders will continue to support the Bank's direction of phasing out its operations in the EU8 countries.
- At the 2007 Annual Meeting, Governors allocated the 2006 net income to strengthen reserves, thereby increasing the Bank's financial capacity to support higher-risk initiatives in the South and East. At that time, Governors also asked that, going forward, the Bank develop other options prescribed by the EBRD's Articles of Agreement,[9] specifically, funding for other purposes, such as technical assistance/cooperation and a "distribution" to shareholders (i.e. payment of a dividend). Achieving agreement among shareholders on income allocation and capital adequacy will remain an ongoing challenge for the EBRD.

[8] The Bank's actual operations have been much higher than projected in CRR3, mainly due to an increase in the number of projects. The portfolio is now forecast to reach €26.2 billion in 2010, with an annual volume of €6.3 billion. The geographic composition is expected to increase even further in favour of Russia (43 per cent of the Bank's portfolio in 2010). The reported portfolio is currently estimated at €20.2 billion, up 14 per cent from 2006. The number of active portfolio operations increased by 5 per cent to 1,341 at the end of 2007. Following Board approval to revise downward the planning €/US-dollar exchange rate to reflect the US-dollar depreciation against the euro, the Bank's capital utilization, with no allocation of net income to the Bank's reserves, is estimated at 87 per cent, relative to the 82 per cent set in CRR3.

[9] In 2006, the EBRD's unrestricted reserves increased above 10 per cent of its authorized capital stock. As a result, in accordance with Article 36 of the Bank's Articles of Agreement, Governors now annually consider and decide among three net income allocation options: (i) to strengthen reserves; (ii) to fund "other purposes"—such as technical assistance/cooperation; and (iii) to make a distribution to shareholders.

Chart 2
EBRD Annual Investments and Gross Disbursements

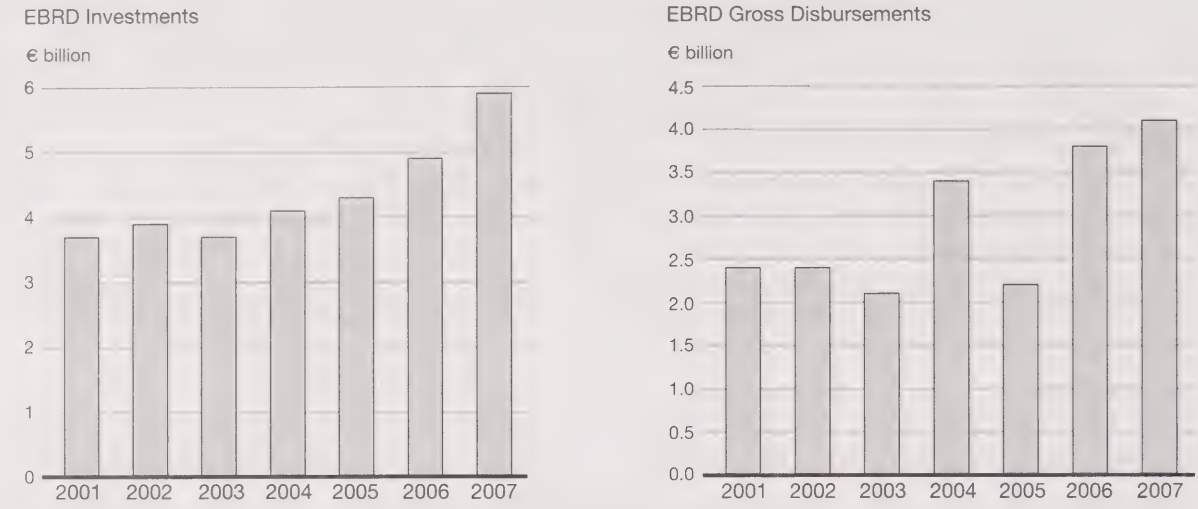


Table 2
Financial Results (2004–2007)

	2007	2006	2005	2004
Number of projects	353	301	276	265
EBRD financing (€ million)	5,583	4,936	4,277	4,133
Resources mobilized (€ million)	8,467	8,915	6,211	8,799
Total project value (€ million)	14,050	13,851	10,499	12,932
(€ million)				
Operating income	1,934	2,667	1,543.9	658.6
Expenses and depreciation	(251)	(225)	(218.9)	(189.8)
Operating profit before provisions	1,683	2,442	1,325.0	468.8
Provision for impairment of loans and guarantees	201	(53)	200.6	(67.2)
Net profit for the year	1,884	2,389	1,525.6	401.6
Reserves and retained earnings	8,676[1]	6,974	4,656.1	1,686.0
Provisions for impairment of loans and guarantees (cumulative)	124	341	351.6	539.5
Total reserves and provisions	8,800	7,315	5,007.7	2,225.5

[1] A decision regarding the allocation of the Bank's 2007 net income will be taken by Governors at the 2008 Annual Meeting. For presentation purposes, the report has included net income in the reserves and retained earnings figure.

Canadian Policy Priorities in 2008–2010

Between 2008 and 2010, the Government of Canada has three priorities for the EBRD. These priorities respond to the challenges identified in the previous section. The rationale behind Canada's priorities for 2008 to 2010 is that strong results should inform and guide the Bank's activities to ensure consistency with the EBRD mandate of:

1. Promoting good governance and accountability, and effective use of the Bank's capital base.
2. Ensuring that the EBRD maintains a strong transition focus and is highly selective in its programming.
3. Promoting environmental sustainability and gender equality of EBRD projects.

1. Governance and Accountability

Greater Transparency in the Appointment Process of the EBRD President

Canada continues to support the Bank's commitment to enhance the transparency of its own activities, which is in line with modern corporate governance practices. This focus is also consistent with efforts at other international financial institutions (IFIs).

President Jean Lemierre will step down as the President of the EBRD in July 2008. The 63 Governors, who are responsible for electing the head of the EBRD, will be asked to vote for his successor. The new President will be elected at the Annual Meeting in Kiev in May 2008 by a majority of Governors' votes. An open and transparent nomination and selection process for the President of the EBRD is a priority for Canada. This will ensure that any member country can nominate a candidate, that the process is guided by publicly available rules and procedures, and that a majority vote or consensus decision should be reached based entirely on the merit of the candidate. The EBRD should move towards these types of clear and public rules.

Action in 2008: Push the Bank to develop a transparent, open and merit-based process for selection of the President that is in line with the standard developed by other IFIs.

Action in 2009–10: Encourage the Bank to consider officially incorporating the new process into the EBRD by-laws.

Sustainable Finances

Canada strongly supports good financial governance at all IFIs. It ensures the development and implementation of sound administrative budgets and an adequate capital base that supports the IFIs' mandates.

Sufficient Administrative Budget in Support of the EBRD's Mandate

As mentioned earlier, in the South and East projects require greater oversight and capacity building. In line with CRR3, over the last two years the Bank's budget was increased by a total of 7.5 per cent to enable the EBRD to achieve the right skill mix and staff level. As transition proceeds at different paces across the South and East, the Bank will need to ensure that it is effective and efficient in its allocation of funds and that the budget is aligned with its strategic directions. This means that the Bank will need to look at an internal reallocation of resources from less relevant activities to fund emerging priorities.

A Sustainable Capital Base

For the last two consecutive years, the Bank's results, driven mainly by high portfolio growth, have exceeded the projections of CRR3. The high growth in the EBRD's portfolio has put pressure on the Bank's capital adequacy and risk ratios. The Board is currently considering options aimed at rebalancing portfolio growth in line with the capital base that supports Bank activity. It is important that the Bank use its limited resources to focus effectively on its core mandate. The decision taken by the Board must ensure adequate discipline and selectivity in the use of capital. It must also set a target for a sustainable portfolio size and, as a result, the scope of activities and their consistency with the mandate.

Action in 2008: Advocate for a reformed process for preparing the Bank's budget and work plan (such as a three-year rolling plan), similar to requirements of the Canadian Financial Administration Act.

Action in 2008: Advocate for a decision on the 2007 net income allocation which ensures discipline and selective use of the Bank's capital in support of activities that are consistent with the EBRD's mandate.

2. Institutional Effectiveness

Article 1

Canada is a strong proponent of the Bank's ongoing efforts to improve and strengthen governance and accountability in its countries of operations (through technical assistance programs and dialogue with national and local authorities); to promote increased transparency, optimal use of investment funds, the rule of law, human rights, safety and equality; and to encourage mechanisms of multilateral cooperation on democratic issues. EBRD analysis shows that the establishment of strong, democratic institutions is a key transition success factor. The need for good governance in all recipient countries will continue to figure prominently in the period ahead, and the EBRD will need to promote sound institutions, more efficient tax collection and improved legal and regulatory frameworks. It must ensure not only that appropriate legislation is developed, but also that it is properly implemented and enforced. Canada has maintained that the Bank's fundamental priority for private sector development is to create an enabling environment for investment supported by sound regulatory frameworks. Good governance helps ensure that corporations integrate into the international financial system and strengthens their international competitiveness.

In keeping with its mandate to promote economic and democratic reform, the Bank regularly reviews its countries' political and economic progress toward transition. In countries where the commitment to core democratic principles is particularly weak (such as Belarus, Turkmenistan and Uzbekistan), the EBRD has limited its operations. In countries where the willingness of governments to move forward with reforms is diminishing, the Bank should focus on identifying projects where it has the potential to effect "bottom-up" change by championing best business and environmental conduct. Specifically, the Bank should select private sector clients that are likely to lead the rest of the industry to adopt best practices in the area of environmental and business conduct.

Action in 2008: Actively participate in Board discussions on the Uzbekistan and Turkmenistan country strategies. If the analysis indicates that these countries have been slow in implementing Article 1, continue to support limited scope of Bank activities (i.e. support small EBRD operations with private sector entities that address basic human needs).

Action in 2008: Press the Bank to identify effective approaches for supporting transition in countries whose commitment to democratic and economic reforms is waning. For example, the Bank should consider focusing on engagement with companies that can demonstrate to the rest of the industry the benefits of environmental and business best practices.

Strong Transition Impact

Canada has a strong interest in ensuring that nascent democratic regimes have access to the financing and advice they need to make successful and sustainable transitions to market-oriented democracies. The EBRD has an important role to play in these efforts. The entry of eight EBRD borrowers into the European Union in May 2004 marked a significant milestone in the transition process. The EBRD played no small part in this process, as it assisted the countries in building the right conditions to attract private sector financing.

As the Bank begins to fund increasingly higher-risk projects in the South and East and pushes governments to continue with more difficult reform efforts, greater importance will be placed on reviewing operations to assess their effectiveness, learn from past experience and improve the development of future projects. The Evaluation Department, an independent group reporting directly to the Board of Directors, will play an even more essential role in assessing the EBRD's performance and providing advice on how to improve it.

The current system of assessing transition impact was developed 10 years ago and was mostly focused on advancing and measuring transition in the EU8. Now, as the Bank shifts its focus to the East and South, there is a need to modify the ratings to better account for the characteristics of its new clients. Specifically, the current criteria should include indicators such as development, poverty alleviation, institution building or sustainability, which indirectly affect transition to a market economy.

Action in 2008: Encourage the Bank to continue its analysis of indicators to ensure a better assessment of its transition impact.

Action in 2008: Encourage the Bank to calculate the financial and economic rate of return for projects to better capture the viability of the EBRD's investments.

3. Environmental Sustainability and Gender Equality

Environmental and social issues are increasingly regarded as fundamentally interconnected with long-term economic and political sustainability, as well as the quality of life for a region's inhabitants. Canada has an interest in promoting sustainability in the region as a means of fostering a strong global economy. Canada is therefore a strong proponent of sustainable best practices with respect to the EBRD's investments.

The current Environmental Policy was approved by the Board in April 2003. In 2006, the Bank decided to review the policy to better respond to the environmental and social challenges in its countries of operations, and to reflect emerging best practice among the IFIs and the private sector. For example, the standards adopted by the International Finance Corporation have become a point of reference with respect to environmental and social sustainability.

The policy revision process took place throughout 2007. A round of public consultations outlining key topics was held with non-governmental organizations, other financial institutions, the World Health Organization, the International Labour Organization and indigenous peoples' representatives. The Bank is currently working on draft language for the new policy, which is expected to be ready for public discussion in the first quarter of 2008.

Gender equality is a cross-cutting theme of Canada's development assistance throughout Eastern Europe. The EBRD made a commitment to mainstream gender equality in its programming. Much work will be required in the coming year to reach this objective and Canada, in collaboration with other like-minded donors, will continue to make it a priority in our relationship with the institution.

EBRD environmental and social priorities include:[10]

- Fully integrating environmental and social considerations (e.g. health and safety, labour and community issues) into the project cycle and ensuring that each project considered for financing undergoes environmental and social appraisal.
- Promoting environmental investments across a variety of sectors to achieve resource efficiency, cleaner production processes, biodiversity and best practice in environmental management.
- Financing projects with clear environmental objectives, such as better water and waste water management, energy efficiency and renewable energy; and working in partnership with other institutions to address regional and global environmental issues.

Action in 2008: Advocate for a timely adoption of the Bank's Environmental and Social Policy, with a target date of the summer of 2008.

Action in 2008: In collaboration with other donors, encourage the Bank to develop and implement gender policy, similar to what is being done at other international financial institutions.

Action in 2009–10: Encourage the Bank to develop a methodology to collect sex-disaggregated data and include gender equality in project assessment. Over time, as more data become available, press the Bank to consider mainstreaming gender equality into its Environmental and Social Policy.

[10] EBRD Sustainability Report, 2005.

Annex 1—2007 Governor's Speech

Statement by Diane Ablonczy, Temporary Alternate Governor for Canada, at the EBRD Annual Meeting Kazan, Russia, Monday, May 21, 2007

It is a pleasure to address you today in Kazan, and I thank the Government of the Russian Federation and the authorities of the Republic of Tatarstan for hosting our meeting this year. We hope that this meeting will spur investor interest in the tremendous commercial opportunities offered by the region. The Republic of Tatarstan, like Canada, is a testament to the prosperity that can be achieved when people of diverse religious and cultural backgrounds strive to achieve common goals. I am particularly encouraged by the engagement of the Government of my province, Alberta, and Canadian and Tatar private sector partners in a heavy oil knowledge and technology dialogue. I hope that the seminar will lay the foundation for further exchange of experience and expertise related to technological advancements in the development of heavy oil and will result in a strong commercial partnership between the Republic of Tatarstan and the Province of Alberta.

The location of this year's meeting, in this dynamic region of the Russian Federation, is a concrete expression of the Bank's role as the catalyst for increased flows of financing to the private sector. It also is a testament to the EBRD's medium-term strategy approved at the 2006 Annual Meeting, centered on shifting Bank operations further south and east—to South East Europe, the Commonwealth of Independent States, including Russia and Central Asia, and Mongolia—regions where the largest transition challenges remain. We trust that this gathering will encourage these regions in their transition efforts.

A Stronger Focus

Consistent with this geographical shift, the Bank has been working hard to support the efforts of the less advanced countries in furthering their transition. Today, we are talking about the EBRD's renewed mission in these countries, aimed at assisting them to reach a path of sustainable growth based on market and democratic principles. Canada values measuring results and in this vein, we welcome the practical steps the Bank has taken to close three offices in Central Europe this year and to redeploy resources into areas where transition is less advanced.

The Bank's increased focus on the "South and East" requires a continuing assessment of both challenges in the region and the means of addressing them with the right product mix and policy dialogue. Improving the investment climate and enabling environment in countries and regions where the EBRD operates is critical for the success of the Bank's projects and private sector development more generally. The EBRD is well placed, through its technical cooperation programs and policy dialogue, to help countries improve their investment and business climates, transfer knowledge and build the right institutions. Canada is pleased to financially support the Bank's capacity building efforts, through bilateral and multi-donor funds. Given the EBRD's impressive financial performance, we look forward to the Bank contributing some of its net income to the same purpose.

Strengthening the Bank's focus on the core transition challenges requires focus on measurable results. Measuring the impact of its projects is critical for results-based business planning and is key to ensuring that the Bank plays to its comparative advantages. With the new framework approved at last year's Annual Meeting in London, Canada is looking to the Bank to sharpen its priorities and focus in the South and East where the Bank can best facilitate transition.

A Strong Institution

2006 marked the first year of the Bank's operations under its new medium-term strategy. The financial results for 2006 were exceptional—for the first time since the Bank's founding, EBRD's unrestricted reserves increased above 10% of its authorized capital stock. As a result, in accordance with Article 36 of the Bank's Articles of Agreement, from now on, Governors will annually consider and decide amongst three net income allocation options: (i) to strengthen reserves; (ii) to fund "other purposes"—such as technical assistance; and, (iii) to make a distribution to shareholders. We support the prudent approach of using the 2006 resources to strengthen reserves this year, thereby increasing the Bank's financial capacity to support initiatives in riskier regions. However, moving forward we would want to see a full and timely evaluation of all options for allocation of net income within the framework of supporting the institution's core mandate.

Article 1 Challenges Remain

As the geographic focus of the Bank's operations continues to shift, the EBRD's strong commitment to the political requirements of Article 1 remains imperative. As shareholders, we have a responsibility to ensure that the institution's activities respect Article 1. More than a decade of the EBRD's transition experience has demonstrated that pluralism and democracy are essential to mobilizing both internal and external resources for investment and remain a key transition success factor.

Canadians have experienced the value of the Article 1 principles first hand. Our commitment to promotion of human rights, our steadfast support for multi-party democracy, pluralism, and market economics has produced concrete socio-economic benefits. Canada therefore strongly supports the EBRD's decision to limit operations in countries where commitment to these core principles remains weak. The Bank needs to remain vigilant in applying Article 1 principles, and constantly encourage countries of operation to commit fully to those principles. Going forward, the Bank needs to ensure that its activities reinforce good corporate governance and strengthen the investment climate.

Raising Standards

Good governance helps locally-owned companies in its countries of operations compete regionally, and even globally. By holding business partners to the highest standards of business practice, transparency, and accountability, the EBRD demonstrates that sound corporate behaviour, which is environmentally sensitive and promotes sustainable development, is consistent with profitability and the promotion of growth and prosperity. The EBRD must continue to promote good governance as a cornerstone of its work with the public and private sector partners.

This year, the Bank will make a further contribution to raising business standards in the renewal of its Environmental Policy, which will be broadened to embrace more social aspects of financial transactions. We welcome the review and look forward to having social issues more systematically addressed in the region. The inclusion of gender in the new Policy should recognize the important contribution that women make to growth and prosperity.

This renewal builds on the Bank's "Sustainable Energy Initiative" and work promoting energy efficiency. The Bank's increased efforts in this area respond to the G-8's call for international financial institutions' leadership in helping address the interrelated issues of long-term energy security and climate concerns. By financing the transition to cleaner energy and energy efficiency, the EBRD is making an important contribution to helping the region reduce its carbon footprint. Reducing a region's footprint is a challenge that my Government knows well, as we are working hard to reduce Canada's.

Of course, to achieve a sustainable, broad-based increase in standards, international financial institutions must work together. Such cooperation is essential, not only to avoid a "race to the bottom", but also to ensure that each plays to its comparative advantage in delivering its mandate. We ask President Lemierre, management and the Board of Directors to work with other institutions to this end, and promise that Canada will do its part at the other international financial institutions in which it is a shareholder.

Conclusion

In closing, I would like to thank President Lemierre and his staff for a productive year. Challenges certainly remain. However, Canada has every confidence that the Bank will continue to achieve progress in the coming year.

Annex 2—Summary of the *Transition Report*

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition from a centrally planned to a market economy in each of the Bank's 29 countries of operations. The *Transition Report* is recognized as the leading publication analyzing the progress of transition in the former Soviet bloc. The 2007 report gauges peoples' attitudes toward transition and ongoing reforms. The report presents key findings of the 2006 EBRD/World Bank Life in Transition survey, which provides unique insights into how the transition has affected peoples' standard of living as well as their expectations about the future.

Macroeconomic Overview and Reform Progress

The EBRD reports that the transition region continues to catch up with Western Europe and other mature market economies. It finds that transition is being driven increasingly by competitive markets rather than by governments. The 2006 average economic growth reached 6.9 per cent, the highest level since the transition started in 1991 (as compared to 5.8 per cent in 2005).

The report explains that growth was partially due to strong domestic demand (supported by rapid expansion in lending by domestic and foreign banks), high foreign direct investment and significant remittances from workers abroad. Export growth was also up, mirroring strong global demand. These factors put upward pressure on inflation throughout the region, to which many central banks responded with anti-inflationary measures, such as raising interest rates and stricter regulations on minimum reserves. Against this backdrop, the EBRD reports fiscal policy as being too loose to stem domestic demand. In fact, a number of countries plan high increases in their budgets to fund social security, pensions and public sector wages. In addition, political instability continues to hamper prospects of far-reaching fiscal consolidation, which the Bank believes necessary given the long-term implications of aging populations.

In resource-poor countries, booming consumption and investment in 2006 resulted in wider current account deficits. For example, Ukraine recorded its first current account deficit in eight years, while in Latvia it has doubled to 21.3 per cent of GDP. On the other hand, Russia and the Commonwealth of Independent States continued to benefit from high oil revenues. For example, in Kazakhstan, the 2006 current account surplus was 18.2 per cent of GDP.

The global liquidity crisis that began in the summer of 2007 has had a limited effect on the transition countries so far. Nonetheless, the report forecasts that the re-pricing of risk and higher costs for inter-bank lending will reduce demand for bank credit and lower consumption and investment, and may lead to slower economic growth in the region.

In the context of these macroeconomic challenges, the Bank reports progress in the reform process. As shown in the following table, the Bank reports 20 transition score upgrades in 14 countries and no downgrades in 2007. The Bank tracks reform developments in 29 transition countries through a set of nine transition indicators. These cover four main elements of a market economy—markets and trade, enterprises, financial institutions and infrastructure. Market liberalization—or initial-phase reform—was reported to be virtually complete in the advanced countries of Central Europe and the Baltic region and in much of Southeastern Europe, but there is still room for improvement in the Western Balkans, the Commonwealth of Independent States and Mongolia. Second-phase reform—building market-supporting institutions, such as large-scale privatization, governance and enterprise restructuring, competition policy, financial sector development and infrastructure—is far from complete.

Table 3

Progress in Transition in EBRD Countries of Operations

			Enterprises			Markets and trade			Financial institutions		Infrastructure
Countries	Population (millions, mid-2007)	Private sector share of GDP in %, mid-2007 (EBRD estimate)	Large-scale privatization	Small-scale privatization	Governance and enterprise restructuring	Price liberalization	Trade and foreign exchange system	Competition policy	Banking reform and interest rate liberalization	Securities markets and non-bank financial institutions	Infrastructure reform
Albania	3.2	75	3	4	2+	4+	4+	2	3-	2-	2+↑
Armenia	3.2	75	4-	4	2+	4+	4+	2+	3-	2	2+
Azerbaijan	8.4	75↑	2	4-	2	4	4	2	2+	2-	2
Belarus	9.7	25	1	2+	1	3-	2+	2	2↑	2	1+
Bosnia and Herzegovina	3.8	60↑	3↑	3	2	4	4-	2↑	3-	2-	2+
Bulgaria	7.7	75	4	4	3-	4	4+	3-	4	3	3
Croatia	4.4	70↑	3+	4+	3	4	4+	3-↑	4	3	3
Czech Republic	10.3	80	4	4+	3+	4+	4+	3	4	4-	3+
Estonia	1.3	80	4	4+	4-	4+	4+	4-	4	4-	3+
FYR Macedonia	2.0	65	3+	4	3-	4+	4+	2+↑	3-	2+	2+
Georgia	4.6	75↑	4↑	4	2+	4+	4+	2	3-	2-	2+
Hungary	10.1	80	4	4+	4-	4+	4+	3+	4	4	4-
Kazakhstan	15.1	70↑	3	4	2	4	4-	2	3	3-	3-
Kyrgyz Republic	5.1	75	4-	4	2	4+	4+	2	2+	2	2-
Latvia	2.3	70	4-	4+	3	4+	4+	3	4↑	3	3
Lithuania	3.4	75	4	4+	3	4+	4+	3+	4-	3+↑	3
Moldova	3.4	65	3	3+	2	4	4+	2+↑	3↑	2	2+
Mongolia	2.7	75↑	3+↑	4	2	4+	4+	2+↑	3-↑	2	2
Montenegro	0.7	65	3+	4-	2	4	4↑	2-↑↑	3-	2-	2
Poland	38.1	75	3+	4+	4-	4+	4+	3+	4-	4-	3+
Romania	21.7	70	4-	4-	3-	4+	4+	3-	3+↑	3-↑	3+
Russia	144.1	65	3	4	2+	4	3+	2+	3-	3	3-
Serbia	8.3	55	3-	4-	2+	4	3+	2↑	3-	2	2
Slovak Republic	5.4	80	4	4+	4-	4+	4+	3+	4-	3	3-
Slovenia	2.0	70↑	3	4+	3	4	4+	3	3+	3-	3
Tajikistan	6.5	55	2+	4	2-	4-	3+	2-	2+	1	1+
Turkmenistan	6.5	25	1	2	1	3-	1	1	1	1	1
Ukraine	47.1	65	3	4	2	4	4-	2+	3	3-↑	2+
Uzbekistan	26.0	45	3-	3+	2-	3-	2	2-	2-	2	2-

Note: The classification of transition indicators uses a scale from 1 to 4, where 1 implies little or no progress with reform and 4 implies a market economy. A rating of 4+ indicates the country has achieved standards and performance typical of advanced industrial economies. An arrow indicates change from the previous year. One arrow indicates a movement of one point (from 4 to 4+, for example) and two arrows a movement of two points.

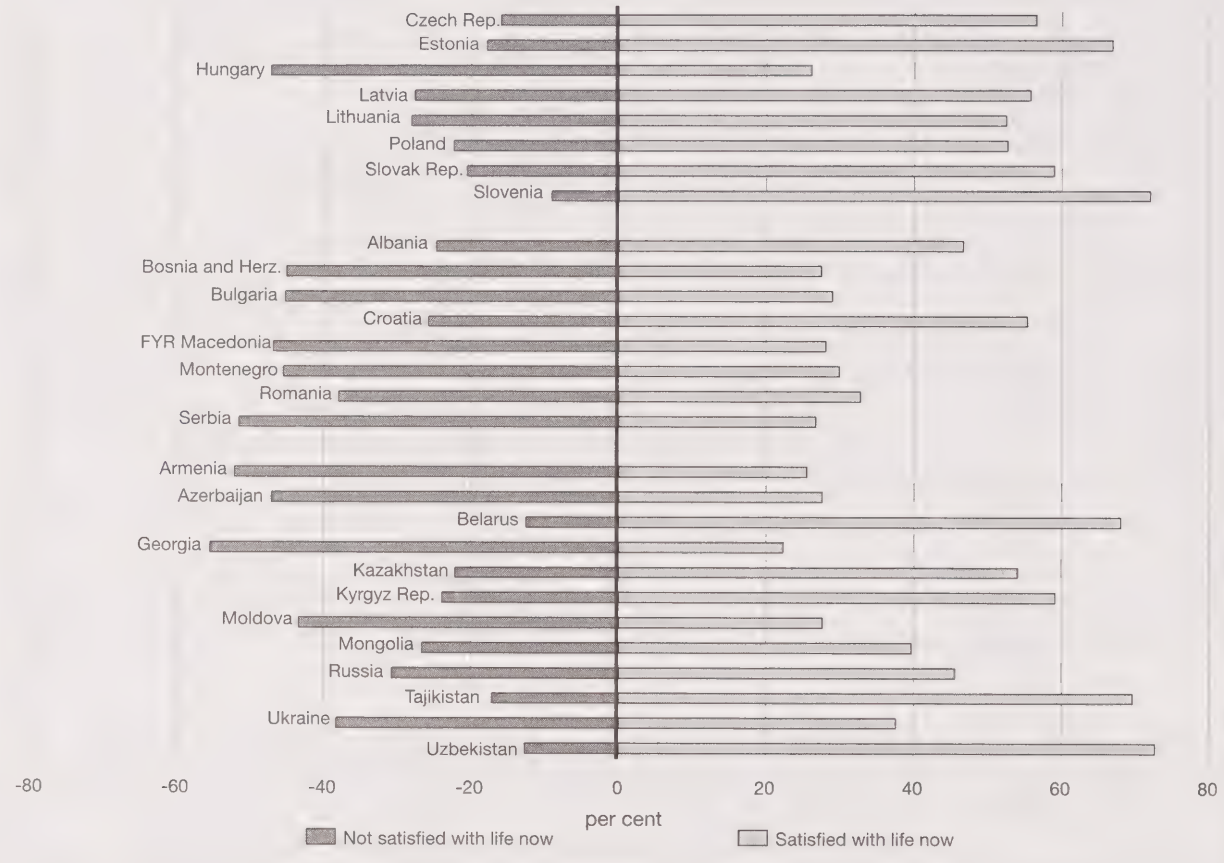
Source: EBRD, *Transition Report 2007: People in Transition.*

Report Focus: "People in Transition"

The EBRD reports that the favourable changes that have swept across many transition countries have brought everlasting improvements to many aspects of life. Democracies and market economies have taken root, businesses and entrepreneurship have flourished and much of the physical infrastructure has been renewed. However, despite high growth rates, across countries and cities, there are large variations in levels of income and opportunities. The survey has found evidence that levels of life satisfaction are lower in the region than in other parts of the world, and in some cases there is a pervasive sense of dissatisfaction with some of the outcomes of the transition process. Support for democracy is fairly strong in the transition countries.

The following charts[11] summarize peoples' attitudes toward democracy and a market economy. They are based on interviews with 29,000 people in 29 countries.

Chart 3
Satisfaction With Life



[11] Source: EBRD, *Transition Report 2007: People in Transition.*

Chart 4

Views on Living Standards Compared With 1989

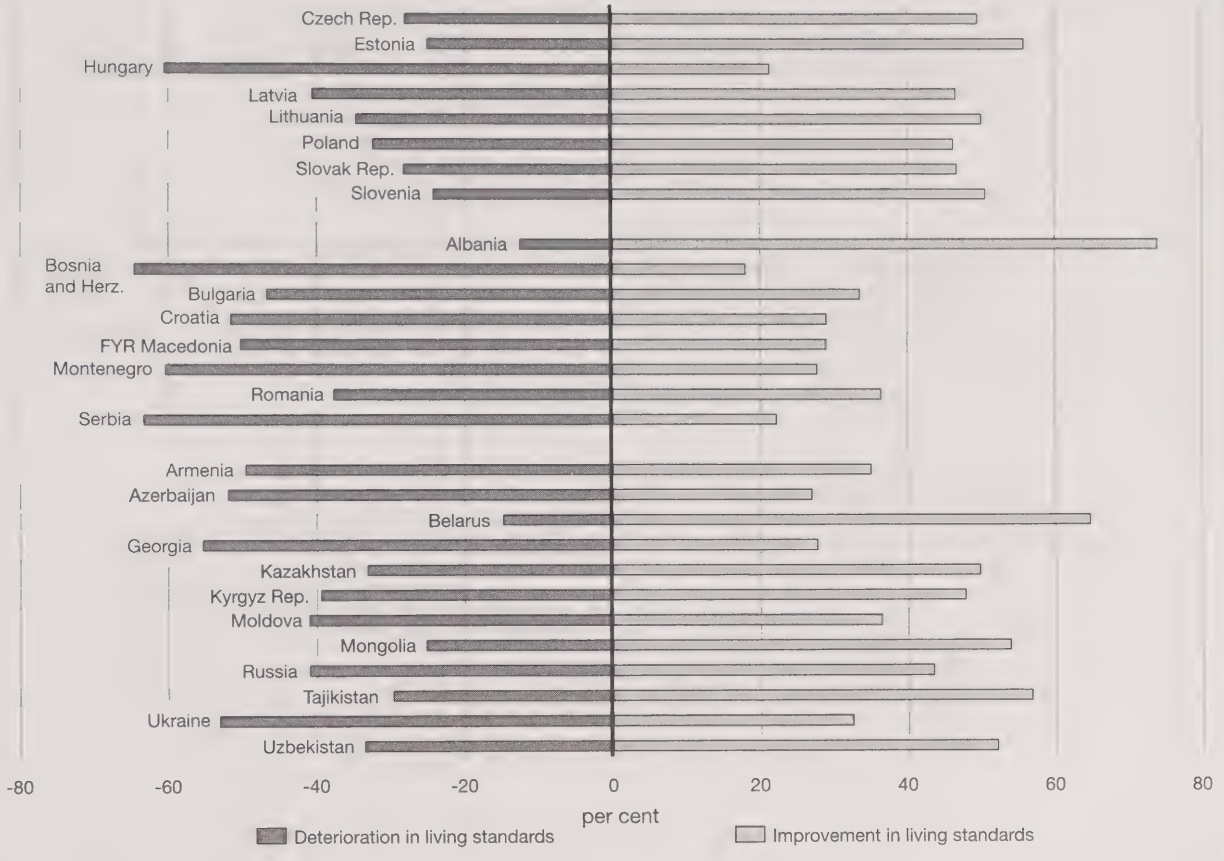


Chart 5

Views on Changes in Household Wealth Since 1989

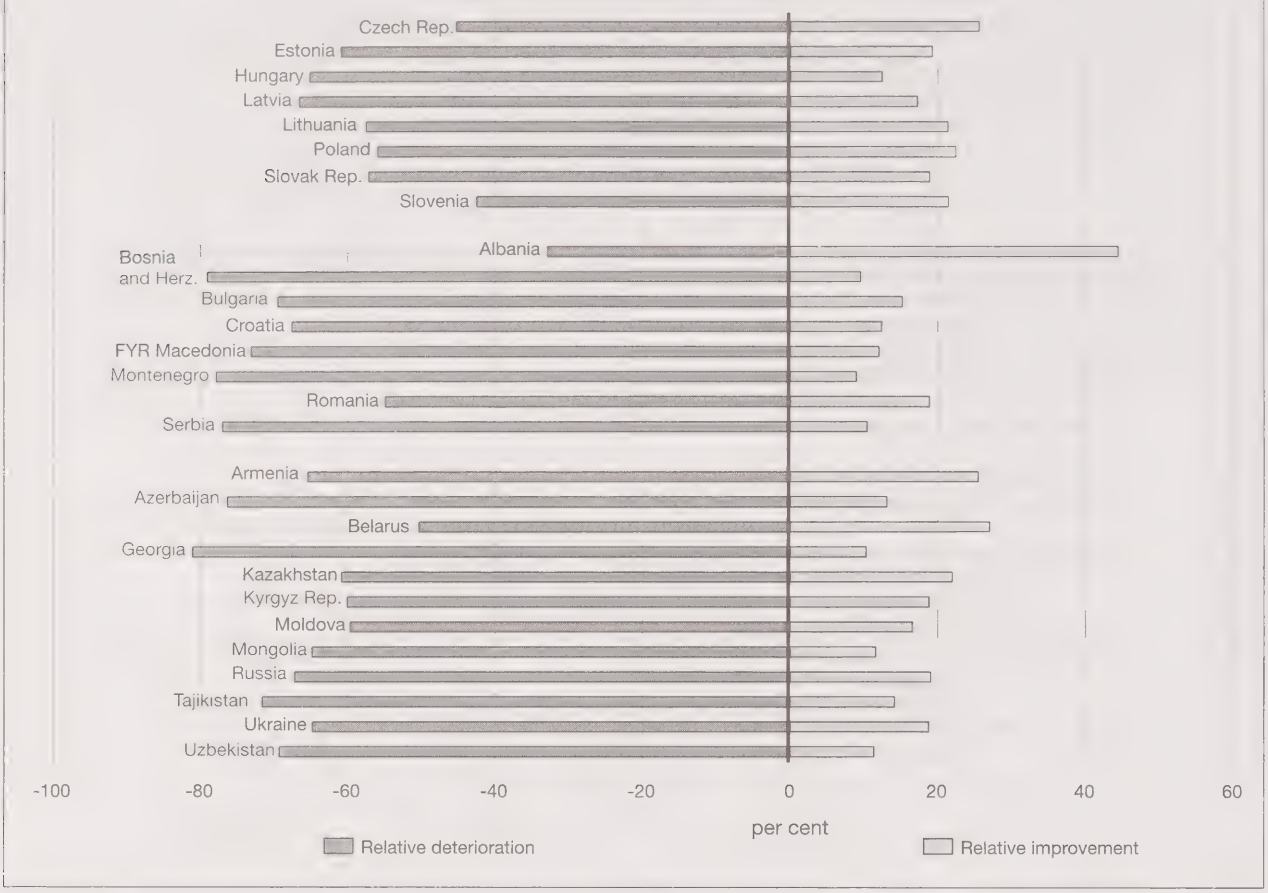


Chart 6

Views on Present Political Situation Compared With 1989

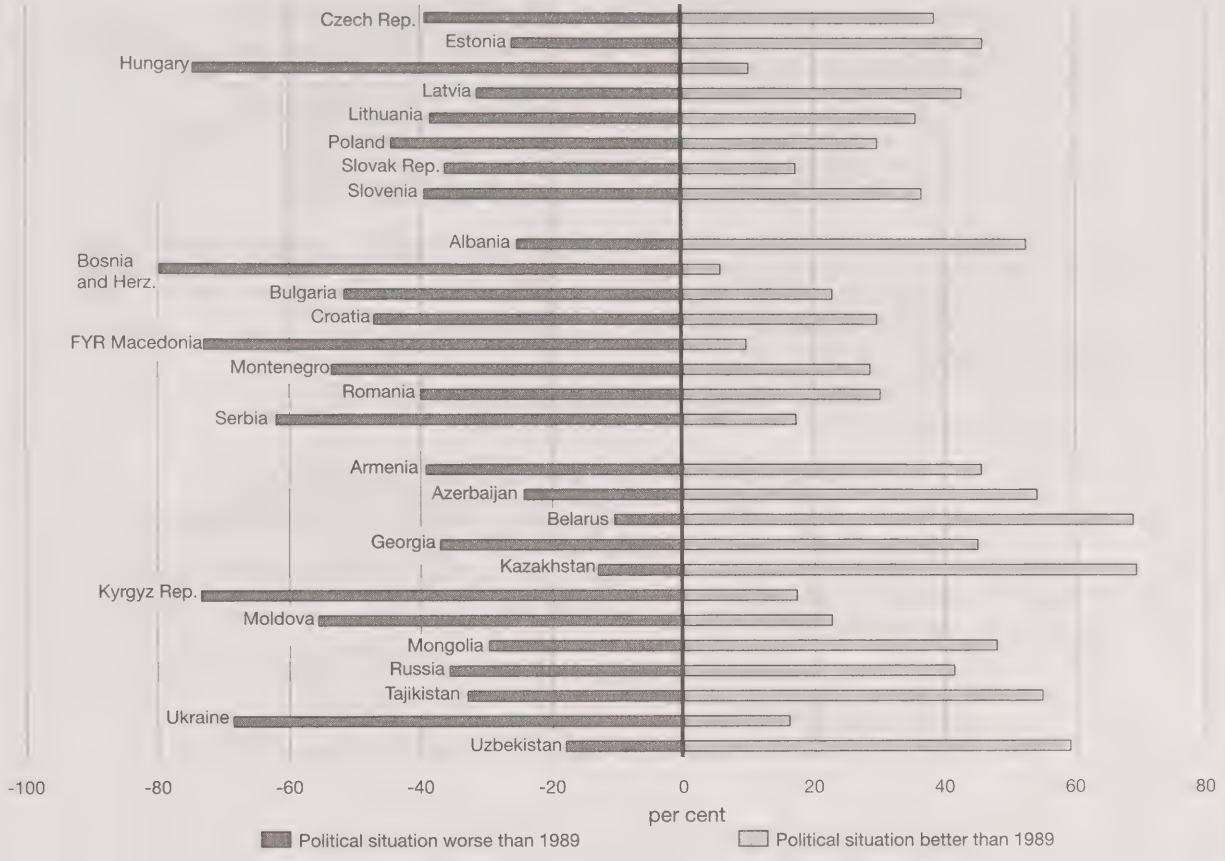


Chart 7

Views on Present Economic Situation Compared With 1989

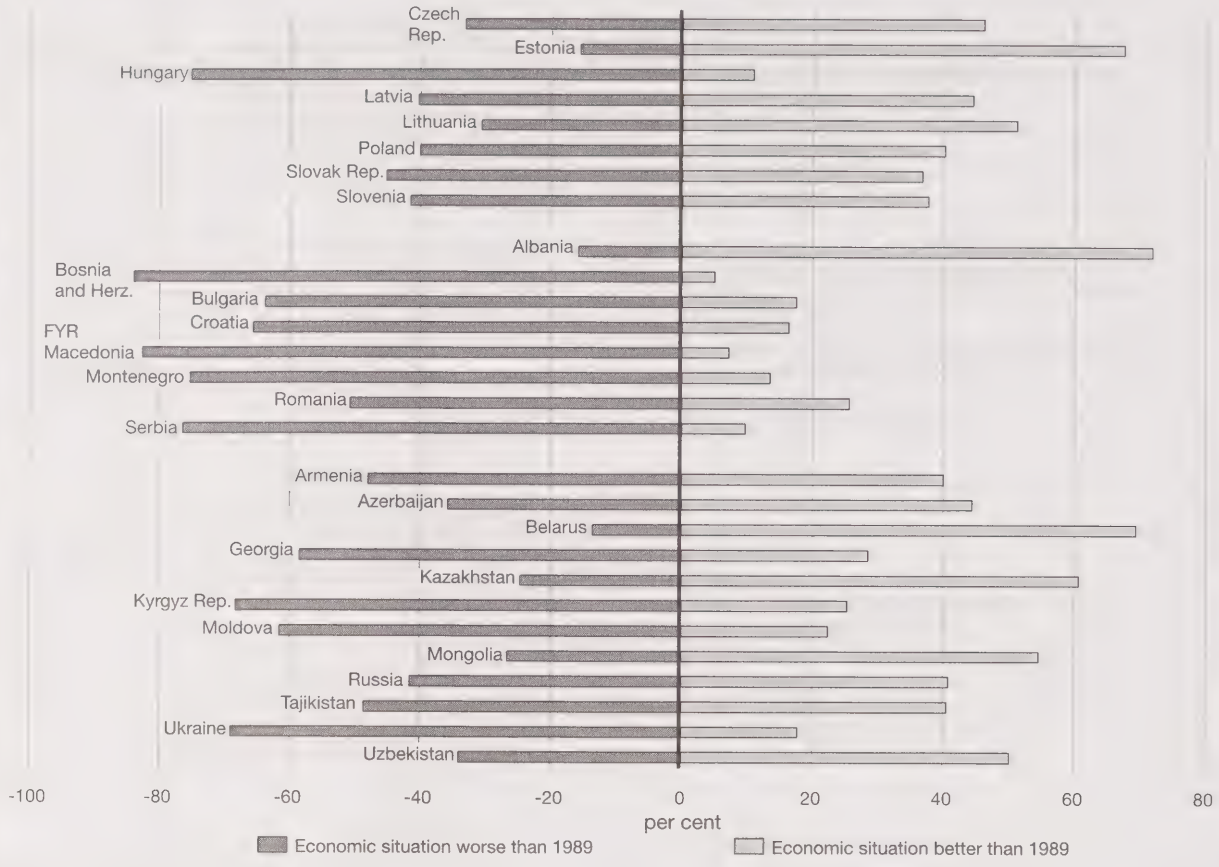


Chart 8

Support for Democracy Versus Authoritarianism

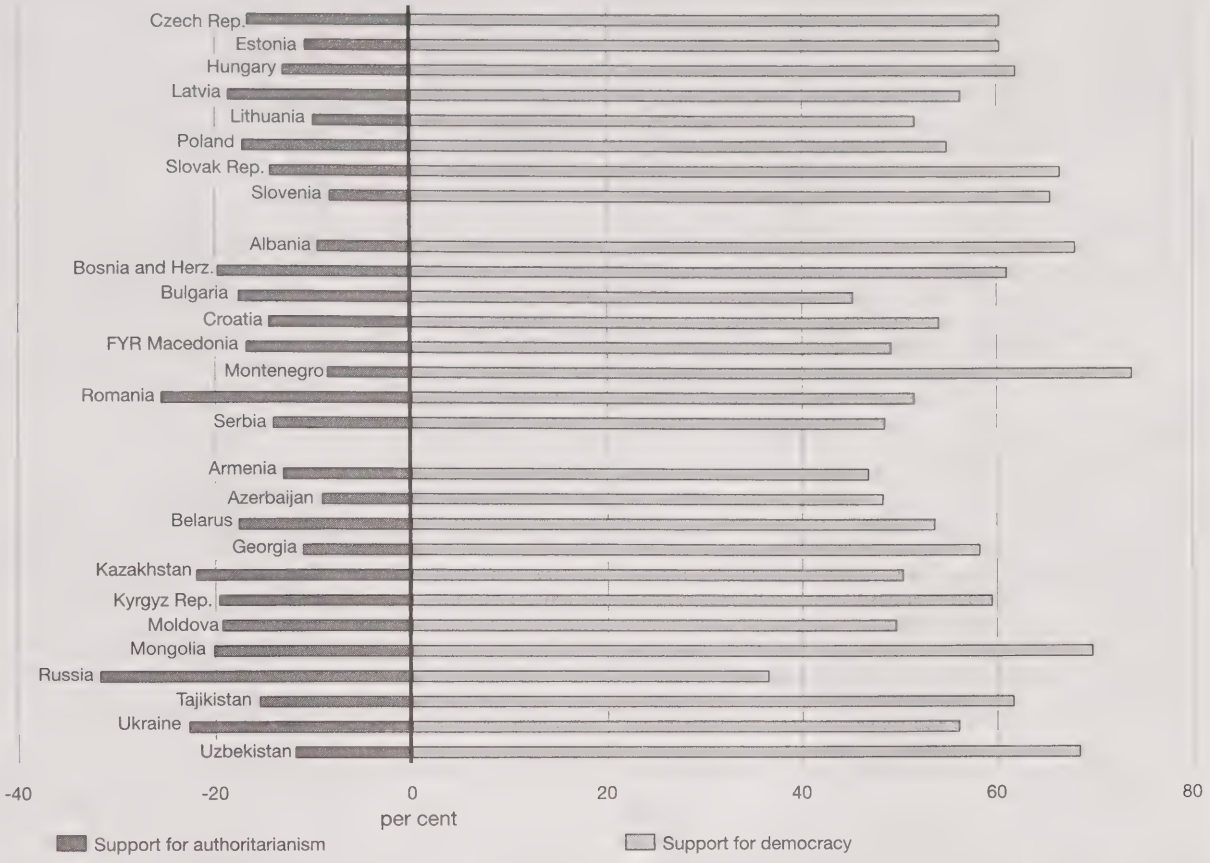
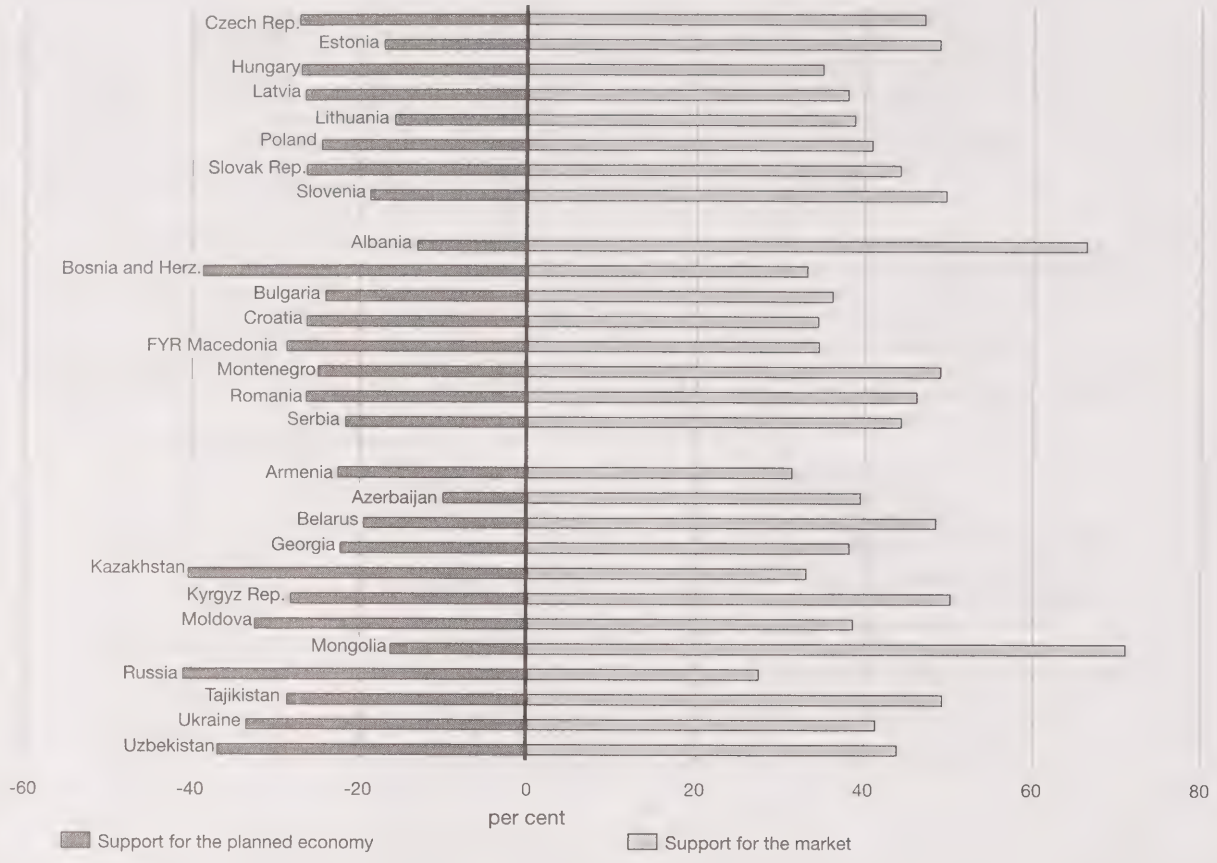


Chart 9

Support for the Market Versus Planned Economy



Annex 3—CIDA Programming in EBRD Countries of Operations

In order to increase the effectiveness of its programming, CIDA is focusing its efforts on a limited number of countries in the region. Efforts in the region are therefore concentrated in Ukraine, which is the main country of operation. CIDA also has active bilateral programming in the Balkans (Bosnia and Herzegovina, Serbia, and Montenegro), Tajikistan and Russia, as well as regional programming in the South Caucasus (Armenia, Azerbaijan and Georgia). The timeline for disengaging from the Balkans is 2010. The highlights of CIDA's programming in EBRD countries of operations can be found below.

Ukraine—Since 1991, Canada has provided C$342 million in development assistance to Ukraine. CIDA's Ukraine Program focuses on democratic governance, with particular emphasis on accountable public institutions and the rule of law, as well as private sector development and the enabling environment for business. The 2008–2012 Country Development Programming Framework for Ukraine is currently in the advanced stages of development.

Russia—As a G8 member, a nuclear power, a key partner in the fight against terrorism and Canada's largest northern neighbour, Russia is of great strategic importance. To date, Canadian technical cooperation programming expenditures in Russia total over C$350 million. Current CIDA programming in Russia is focused on delivering results related to governance and economic well-being. It covers four areas: increasing public sector competence, building an enabling environment for a market economy, building an engaged civil society, and supporting sustainable regional economic development in the Russian north. CIDA's Russia Program is preparing a new programming strategy that will manage a smaller but strategically focused program that targets democratic governance. CIDA will continue to emphasize a whole-of-government approach to the Canada-Russia relationship.

Balkans—The international community's strong commitment to peace, stability and cooperation in the Balkans has started to show concrete results. A fragile peace has emerged, and the political discourse is increasingly focused on the future and closely bound with the institutions and prosperity of Europe and EU accession. Since 1990, CIDA has disbursed over C$540 million in funding to the Balkans for approximately 800 projects. The program is focusing its efforts in countries that are key to regional stability: Bosnia and Herzegovina, Serbia (including Kosovo) and Montenegro. CIDA's Balkans Program has shifted from post-conflict technical assistance to institutional capacity building, and is directed at initiatives that contribute to public sector reform and enhance social capital in the areas of rule of law, health and education. Gender, youth, environment and refugees are all cross-cutting issues. CIDA is planning to disengage from the Balkans by 2010.

South Caucasus—CIDA has been present in the South Caucasus (SC) region since 1992, lending its support to initiatives aimed at improving governance structures and institutional capacity, strengthening civil society, promoting peace and security, and enhancing respect for human rights and democracy. To date, CIDA has disbursed over C$60 million in assistance to the SC. The majority of funding has been allocated through responsive programming, with remaining funds provided via humanitarian assistance grants and the Canada Fund. Georgia has received C$33 million, which represents the majority of CIDA'S assistance.

Tajikistan—CIDA's main area of assistance is agrarian reform, as well as the governance and strengthening of private sector development. The initiatives support:

- The development of a comprehensive regulatory system and related procedures in support of the country's agrarian reform (e.g. debt resolution, farm restructuring and land rights).
- The resolution of excessive government centralization and lack of cooperation and understanding between local authorities and communities (e.g. partnership between local governments and civil groups to manage the communities' development).
- Building the capacity of the State Land Committees and community organizations to monitor land reform progress.
- Advancing women's access to land, and assuring their participation in their communities' decision making.
- The reorganization of agricultural enterprises to a market economy, including improved farmer access and utilization of strengthened market information systems.
- The access of farmers to micro-credit and technical assistance.

Europe Regional Program (ERP)—The ERP works with selected multilateral and bilateral institutional partners that are addressing issues of regional and trans-boundary interests in the region. The ERP collaborates with the EBRD and the Organization for Security and Co-operation in Europe in the areas of governance, private sector development and environment, with gender equality as a cross-cutting theme. The ERP helps co-ordinate and facilitate program activities undertaken by geographic programs, and collaborates closely with other government departments to ensure policy coherence and a whole-of-government approach.

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